

# **Office of the Under Secretary of Defense (Comptroller) (OUSD(C))**

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## **Effective Internal Control for Financial Reporting Course**

### **Student Guide**

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<b>Course Title</b>	<b>Effective Internal Control for Financial Reporting</b>
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<b>Course Identification</b>	Course Code: OSD - IC	Course Type: F
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<b>Level and Type</b>	Introductory Functional Course
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<b>Course Length</b>	8 hours	8 CPE credit hours
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<b>Field of Study</b>	Accounting and Audit, Government Accounting and Reporting – Specialized.
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<b>Course Description</b>	<p>The Effective Internal Control for Financial Reporting course, Version 1.0, is an eight-hour, introductory functional course designed to help individuals understand how internal control serves as a basis for an unqualified assurance in the Department environment. This course is designed to be a hands-on, “how to” course, focused on providing students with the understanding of how the maintenance and implementation of an effective program will prepare them for a successful audit. Students learn the objectives of key legislative and regulatory requirements for internal control and how to evaluate internal control within their Department entity. The focus of the course is on four areas, Real Property, Military Equipment, Environmental Liabilities, and Fund Balance with Treasury (FBWT). Students also learn how management assertions provide a test of internal control, and how to document internal control processes as described on the material lines, accounts and significant transactions. Students will learn how virtually every Department job, whether financial or non-financial, is governed by internal control. Additionally, students will be able to describe the impact of the Office of Management and Budget (OMB) Circular A-123, Appendix A, upon financial reporting. This course is a broad overview of the Department of Defense process for reporting assurance. To understand the DoD policies, procedures, and requirements, and specific deliverables, refer to the Managers’ Internal Control Program as prescribed in the DoD Directive 5010.38, “Managers’ Internal Control Program,” DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” and the “Managers’ Internal Control Program Annual Guidance,” references will be provided to the students to understand the DoD policies, procedures, requirements, and specific deliverables.</p>
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<b>Learning Objectives</b>	<p>Upon completion of this course, the student will be able to:</p> <ul style="list-style-type: none"><li>• define internal control and identify its objectives</li><li>• identify material processes and transactions</li><li>• determine risks</li><li>• implement internal control to mitigate risks</li><li>• evaluate internal control</li><li>• document internal control processes</li><li>• describe the impact of OMB Circular A-123 on financial reporting.</li></ul>
<b>Presentation Mode</b>	<p>The primary methods of instruction are conference, questions and discussion, and a final examination.</p>
<b>Who Should Attend</b>	<p>The audience for this course includes all individuals who require an understanding of developing and maintaining effective internal control for financial reporting. It will be composed of civilian and military personnel of various grades and ranks in all positions dealing with financial reporting issues. It consists of financial and non-financial personnel who desire to improve their operations while satisfying Congressional and regulatory audit requirements.</p>
<b>Prerequisites</b>	<p>There are no prerequisites for this course.</p>



## **Course Agenda**

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8:00-8:10	Course Introduction
8:10-9:10	Lesson 1 – Internal Control
9:20-10:20	Lesson 2 – Identifying Processes and Transactions
10:30-11:10	Lesson 3 – Analyzing Risks
11:20-12:00	Lesson 3 – Analyzing Risks (cont.)
12:00-1:00	Lunch
1:00-1:20	Lesson 4 – Assessing Internal Control
1:20-2:00	Lesson 5 – Documenting Internal Control Processes
2:10-3:00	Lesson 6 – Reporting According to New OMB Circular A-123
3:10-3:20	End-of-Course Review
3:20-4:20	Final Examination and Final Examination Review
4:20-5:00	Course Critique

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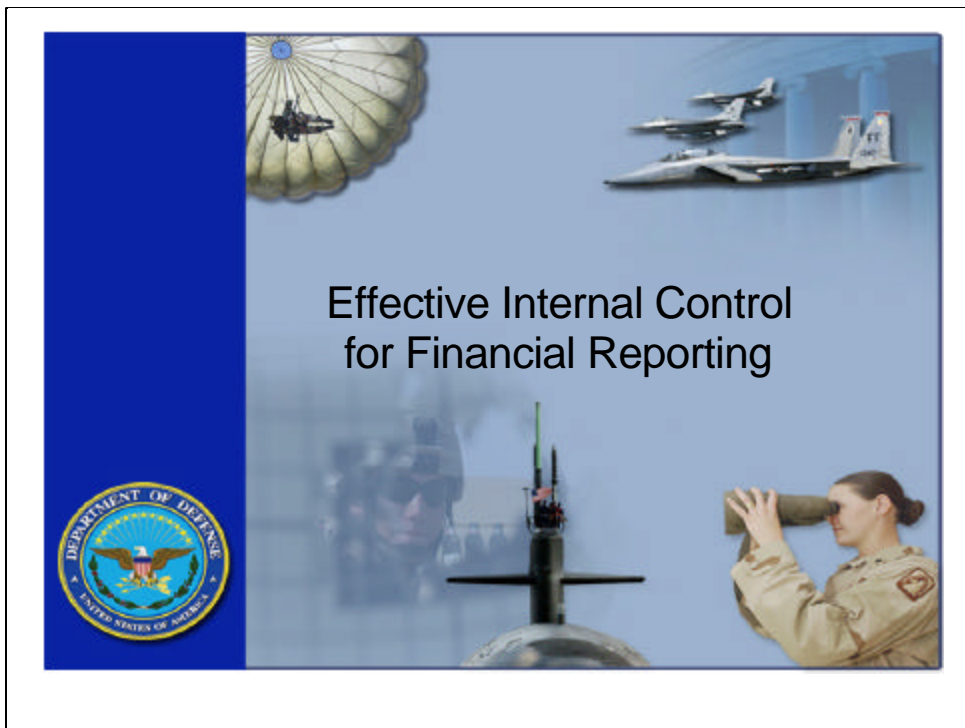
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Good morning and welcome to the Effective Internal Control for Financial Reporting course.

Internal control (IC) can best be defined by the Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Control, December 21, 2004, as the organization, policies, and procedures that agencies use to ensure that programs achieve their intended results; resources are used consistent with an agency's mission; programs and resources are protected from fraud, waste, and mismanagement; laws and regulations are followed; and reliable data are obtained, maintained, reported, and used for program decision-making.

This is an overview of the Managers' Internal Control (MIC) Program as it relates to financial reporting processes. For a complete understanding of the Department of Defense (DoD) MIC Program, students must read OMB Circular A-123, Appendix A, Internal Control Over Financial Reporting; the Department of Defense Directive (DoDD) 5010.38; the DoD Instruction (DoDI) 5010.40; and the MIC Program Annual Guidance.

Before we get into more in depth information, let's discuss some important points.



## Course Introduction



- **Meet your instructor**
- **Housekeeping issues**
- **Other**

Since we are going to be together all day, I would like to start by introducing myself. I am \_\_\_\_\_ and... (name, background, and what makes you uniquely qualified to instruct this course).

Now let's talk about a few general housekeeping topics.

			
 <p>Starting Time</p>	 <p>Coffee Breaks</p>	 <p>Restrooms</p>	 <p>Cell Phones</p>
 <p>Lunch Break</p>	 <p>Phone Calls</p>	 <p>Nondisclosure</p>	 <p>Exercise/Exam</p>
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Restrooms are located at \_\_\_\_\_, and break facilities, coffee, and snacks are located at \_\_\_\_\_. Drinks and snacks are not allowed in the classroom.

Please silence all pagers and cell phones, and refrain from their use while in the classroom. If you must stay in contact, please leave the room to answer a silent page. Telephones for your use are located \_\_\_\_\_.



During this discussion, you will be provided with examples of financial transactions and other proprietary information either from the instruction or from your classmates. You must assume that this information is not for use by the general public, nor is it to be published or disseminated to third parties.








The format for this class is conference/lecture with questions and discussion. There are no practice exercises, but there is a final examination. You may use any materials provided in the course or discussion to complete the examination.















Let's take a look at these materials.

## Icon Definitions

Course/Lesson Flow	
	<b>Logistics</b>
	<b>Starting Time</b>
	<b>Objectives</b>
	<b>Summary</b>
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	<b>Exercise/ Exam</b>
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	<b>Key Point</b>
	<b>Definition</b>
	<b>Background</b>
	<b>Detail</b>
	<b>Law/ Standard</b>
	<b>Example</b>
	<b>Report</b>
	<b>Steps</b>
	<b>Goal</b>
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	<b>Tools</b>
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	<b>Best Practice</b>
	<b>Issues/ Resolutions</b>

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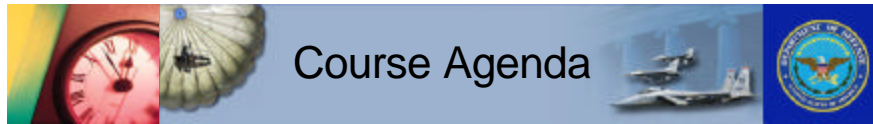
Notice that each page is formatted with a header. The left corner of each header contains an icon that provides a visual key to the contents of the page. For example, this page displays the Logistics icon.

The main icons describe course and lesson objectives and introduce key topics. Additional icons within each topic represent definitions, background information, and issues and resolutions. Best Practice and Example icons will show examples of successful practices implemented by the government or industry. At the conclusion of each lesson, icons will represent the lesson summary, questions and answers, final examination, and links to references available for more information.

Please feel free to take notes on your student materials and to write down any questions that you may have that we may not have had time to address during the discussion of a particular topic. Your questions are very important to us, but we may not have the answer or sufficient time available in the classroom and may have to go to an outside source for an answer.

Now let's examine the course agenda.





Time	Title
8:00 – 8:10	Introduction
8:10 – 9:10	Lesson 1, Internal Control
9:20 – 10:20	Lesson 2, Identifying Processes and Transactions
10:30 – 11:10	Lesson 3, Determining Risks
11:20 – 12:00	Lesson 3, Determining Risks (cont.)
12:00 – 1:00	Lunch
1:00 – 1:20	Lesson 4, Assessing Internal Control
1:20 – 2:00	Lesson 5, Documenting Internal Control Processes
2:10 – 3:00	Lesson 6, Reporting According to New OMB Circular A-123
3:10 – 3:20	Final Examination and Final Examination Review
3:20 – 5:00	Course Critique

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This is our road map for the day.

Class starts promptly at 8:00 a.m. and will break for ten minutes each hour.

Lunch is scheduled from 12:00 p.m. to 1:00 p.m. and class ends at 5:00 p.m.

In this course there are six lessons. Lessons 1, 2, and 3 will be completed before lunch. Lesson 4, along with Lessons 5, 6, and the final review will be completed after lunch. Finally, you will complete a course critique and the instructor will distribute the course completion certificates.

Let's discuss the purpose and objectives.



## Course Overview



**This course provides individuals an understanding of how effective internal control (IC) in financial reporting serves as one of the building blocks for an unqualified audit opinion in the Department of Defense (DoD) environment.**

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CI-6

Management is now required to document the system of internal control over financial reporting as found in OMB Circular A-123, Appendix A. This is OMB's response to the Sarbanes-Oxley Act of 2002 (SOX), Section 404 (Management Assessment of Internal Control). In the public sector, management is required to assess the effectiveness of these controls.

The Auditing Standards Board (ASB) believes that the evidence management uses to support its assertion about the effectiveness of its internal control also should be documented. The ASB believes that a failure to document the system of controls or the evidence used in making the assessment should be considered a weakness in internal control.

The focus of this course is on providing you with the regulatory and legal guidance for establishing internal control, the standards that impact the internal control development, and the understanding that the design and implementation of effective internal control will result in your entity achieving reasonable assurance that its operations, financial reporting, and compliance with applicable laws and regulations are valid. The course concludes with information on reportable conditions, material weaknesses, and reporting on these conditions according to the OMB Revised Circular A-123, Appendix A, which updates management's responsibility for internal control over financial reporting.

Let's look at the course objectives.



## Course Objectives



**Upon successful completion of this course, you will be able to:**

- **Define internal control and identify its objectives**
- **Identify material processes and transactions**
- **Determine risks**
- **Implement internal control to mitigate risks**
- **Evaluate internal control**
- **Document internal control processes**
- **Describe the impact of OMB Circular A-123 on financial reporting**

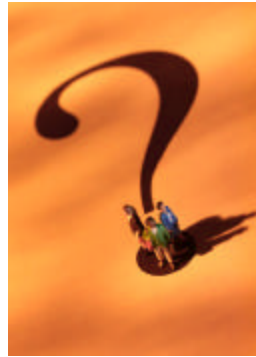
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CI-7

This course will help you understand why well designed, tested, and managed internal controls will assure that the Department achieves a clean or unqualified audit opinion.

Upon successful completion of the course, you will be able to understand how internal control contributes to assertions on financial statement audits and how proper internal control requirements aid in the efficiency of operations.



Before we proceed with Lesson 1, Internal Control, are there any questions?

## Effective Internal Control for Financial Reporting



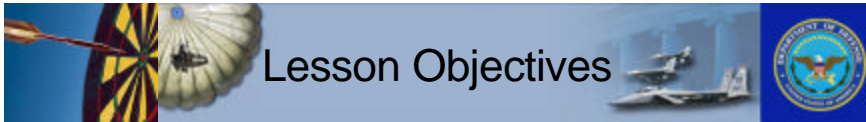
### Lesson 1: Internal Control



In Lesson 1, you will become familiar with the internal control (IC) environment and how risk drives the development and maintenance of an internal control system.

We will look at the types of internal control and their importance in effectively managing resources as well as the relationship of internal control and risk to financial reporting.

Finally, we will review the Government Accountability Office (GAO) and Office of Management and Budget (OMB) requirements and standards based in law that require management to establish effective and cost efficient internal control.



**Upon successful completion of this lesson, you will be able to:**

- **Explain the internal control (IC) environment**
- **Explain types of internal control**
- **Explain requirements, intent, mandates and general themes**
- **Discuss the standards that impact internal control**

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Effective Internal Control for Financial Reporting

L1-2

This lesson describes the internal control environment, the types of internal control, and the standards and requirements that are its basis.

Are authorities and responsibilities clear? Are reporting relationships well designed? What is:

- Management's philosophy and operating style, the integrity, ethics, and competence of personnel?
- The external influences that affect operations and risk management practices (independent audits)?
- The effectiveness of human resource policies and procedures?

Internal control is defined by the OMB Circular (Revised) A-123, Management's Responsibility for Internal Control, as "the tools (organization, policies, and procedures) to help program and financial managers achieve results and safeguard the integrity of their programs." The circular also says "it should be an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing. It should support the effectiveness and the integrity of every step of the process and provide continual feedback to management."

Let's look at the topics supporting these objectives.



**This lesson contains the following topics:**

- **Internal Control Overview**
- **Management's Responsibility**
- **Keys to Developing Valuable Internal Control**
- **Types of Internal Control**

This lesson describes terminology related to internal control. It also describes the responsibilities for implementation and oversight necessary for an effective internal control program.

In this lesson, we will define the keys to developing valuable internal control. This lesson also covers the types of internal control – system, process, and operational.

Let's turn our attention to more topics in our lesson.



## Lesson Topics (cont.)



**This lesson contains the following topics (cont.):**

- **Importance of Internal Control**
- **Relationship of Internal Control and Risk to Financial Reporting**
- **Federal Manager's Financial Integrity Act (FMFIA) and Office of Management and Budget (OMB) Requirements**
- **Government Accountability Office (GAO) and OMB Standards**

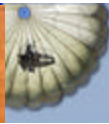
We discuss the importance of internal control and its limitations if not properly designed, monitored, or maintained and the relationship of internal control and risk to financial reporting.

We then explore the laws, directives, and regulations that establish the basis for internal control standards and provide the foundation for the design of effective internal control. The current working and constantly evolving internal control environment is not static and requires that management maintain a constant vigilance over regulatory updates.

Certain terms will be used throughout the course.

Let's take a look at a few of these terms.





## Internal Control Overview



### Terminology

**Internal control is the organization, policies, and procedures which comprise the tools to help program and financial managers achieve results and safeguard the integrity of their programs. The following terminology can be found throughout the internal control processes:**

- **Assertion**
- **Assessable Unit**
- **Compliance**
- **Completeness**

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Effective Internal Control for Financial Reporting

L1-5

Here are a few of the terms that will be referenced throughout the course. A complete listing of terms can be found in Appendix A of the Student Guide.

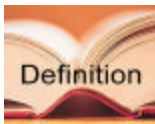
**Assertion** – Explicit and implicit information provided by management that attests to the represented financial position or results of operations.

**Assessable Unit** – An organizational subdivision and part of the total organization that requires compliance with the Internal Control (IC) Program for a Department Component.

**Compliance** – This management assertion ensures that the transactions adhere to the tenets of laws and regulations.

**Completeness** – This category of management assertion attests that all assets, liabilities, and transactions that should be reported have been included and no unauthorized transactions or balances are included.

Let's look at some more terms.



## Internal Control Overview (cont.)



### Terminology (cont.)

- **Financial Control Design Deficiencies**
- **Existence or Occurrence**
- **Internal Control Assessment**
- **Presentation and Disclosure**
- **Rights and Obligations**
- **Risk Assessment**

**Financial Control Design Deficiencies** – These are defects in the processes that will prevent the detection of misstatements on a timely basis.

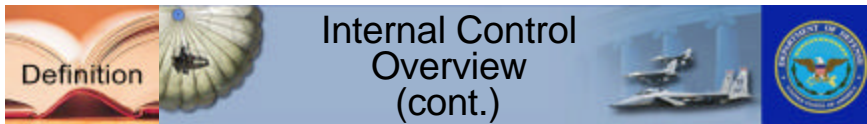
**Existence or Occurrence** – This management assertion attests that all assets and liabilities actually exist at the reporting date and that all recorded transactions occurred during the reporting period.

**Internal Control Assessment** – This management assertion is a documented assessment on the effectiveness and adequacy of the internal controls to meet mission objectives, implemented in a cost effective way.

**Presentation and Disclosure** – This management assertion attests that the financial report is presented in the proper form and the required disclosures are present. The particular components of the financial statements are properly classified, described, and disclosed.

**Rights and Obligations** – This management assertion attests that all assets are legally owned or appropriately reported by the agency and all liabilities are legal obligations of the agency.

**Risk Assessment** – This is how management identifies internal and external risks that could prevent the organization from meeting its objectives.



## **Terminology (cont.)**

- **Reasonable Assurance**
- **Reportable Condition**
- **Risk**
- **Systemic Weakness**
- **Testing**
- **Valuation or Allocation**

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L1-7

**Reasonable Assurance** – An informed judgment by management as to the overall adequacy and effectiveness of internal control based on available information that the internal control system is operating as intended.

**Reportable Condition** – For financial reporting, it is a control deficiency, or combination of control deficiencies, which adversely affects the entity's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with Generally Accepted Accounting Principles (GAAP) such that there is more than a remote likelihood of a misstatement of the entity's financial statements, or other significant financial reports, which is more than inconsequential will not be prevented or detected.

**Risk** – This is the probable or potential adverse effects from inadequate internal control that may result in the loss of government resources or cause an agency to fail to accomplish significant mission objectives through fraud, error, or mismanagement.

**Systemic Weakness** – A systemic weakness is one that materially affects internal control across organizational and program lines and usually affects multiple Department Components.

**Testing** – Procedures to determine, through observation, examination, verification, sampling, or other methods, whether an internal control is working as intended.

**Valuation or Allocation** – A management assertion attests that the assets, liabilities, equity, revenues, and expenses have all been included and properly valued in the financial reports at the appropriate amounts.

Let's continue with a look at responsibility for Internal Control in the Department.



## Management's Responsibility



### Who has the responsibility?

- **Agency management**
- **Field level management**

At the end of the day, who is on the line for the answers to Congressional inquiries? It is management. Management is responsible for asserting on the effectiveness of its internal control.

So let's consider the responsibilities for internal control at the agency and field levels.



## Management's Responsibility (cont.)



**Agencies must establish a process that includes:**

- **Effective internal control**
- **Internal control evaluations that must be performed regularly to ensure that controls are effective**
- **A Statement of Assurance**
- **Accountability**
- **Development and implementation of corrective action plans**

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Effective Internal Control for Financial Reporting

L1-9

Some agencies might ask, “Why should we conform with the laws” or say “We don’t have time to do this.” Agencies cannot afford not to implement internal control. It costs more not to implement internal control than it costs to find answers that save the entities money.

If internal control evaluations are not regularly scheduled in a dynamic environment like financial reporting, the data may no longer be effective and management decisions will be adversely effected.

A Statement of Assurance is your assertion that your internal control is operating effectively or not.

Accountability is the responsibility for effectively and efficiently safeguarding our resources from fraud, waste, and abuse.

A corrective action plan is OMB Circular A-123, Appendix A’s requirement that each agency shall establish systems to assure prompt and proper resolution and implementation of corrective action on material weaknesses over financial reporting.

Let’s move on to the detailed responsibilities of agency management.



## Management's Responsibility (cont.)



### **Agency managers must:**

- **Know the activities for which they are responsible**
- **Know the business processes and related risks**
- **Develop and implement cost-effective controls**
- **Review their internal control**
- **Integrate internal control into each system/process**
- **Above all, ask for help when needed**

Version 1.0

Effective Internal Control for Financial Reporting

L1-10

The detailed responsibilities of agency management are to:

- know the activities for which they are responsible
- know the business processes and related risks
- develop and implement cost-effective controls
- review their internal control
- integrate internal control into each system/process
- above all, ask for help when needed.

The GAO perspective on management responsibility includes the following information:

Federal policymakers and program managers are continually seeking ways to better achieve agencies' missions and program results. In other words, they are seeking ways to improve accountability. A key factor in helping to achieve such outcomes and minimize operational problems is to implement appropriate internal control.

Effective internal control also helps in managing change to cope with shifting environments and evolving demands and priorities. As programs change, and as agencies strive to improve operational processes and implement new technological developments, management must continually assess and evaluate its internal control to assure that the control activities being used are effective and updated when necessary.

Let's now turn our discussion to field level managers.



## Management's Responsibility (cont.)



**Field level managers are responsible for:**

- **Deciding where controls are needed**
- **Designing and developing written descriptions**
- **Communicating these controls to personnel**
- **Putting the controls into operation**
- **Monitoring and improving controls**

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Effective Internal Control for Financial Reporting

L1-11

As you can see at the field level, managers have many responsibilities for internal control requirements. The OMB encapsulates these requirements with the following information:

Field level managers are responsible for deciding where controls are needed, designing and developing written descriptions, communicating these controls to personnel, putting the controls into operation, and monitoring and improving controls.

Management has a fundamental responsibility to develop and maintain effective internal control. The proper stewardship of federal resources is an essential responsibility of agency managers and staff.

Federal employees must ensure that federal programs operate and federal resources are used efficiently and effectively to achieve desired objectives.

Programs must operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement.

Let's look at more field level management internal control responsibilities.



## Management's Responsibility (cont.)



### **Field level managers are responsible for (cont.):**

- **Evaluating controls**
- **Reporting on the controls**
- **Correcting and following up**
- **Annual Statement of Assurance**
- **Consequences for failed controls**

Field level managers are also responsible for the final stages of a good internal control process.

Evaluating controls covers the test process that validates the controls' effectiveness.

Reporting on the controls includes providing the next level management with the information required to assert that your controls exist and are doing the job they are designed to do.

Correcting and providing follow up means that your evaluations and monitoring is effective and is providing you feedback on your internal control.

The Annual Statement of Assurance is prepared by the activity head or Chief Financial Officer (CFO) and its information serves as a basis for the agency's own statement.

Now let's turn our attention to the keys for developing valuable internal control.





### **Keys to developing valuable internal control:**

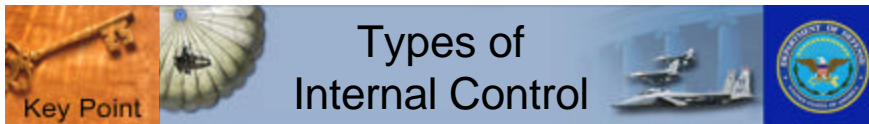
- **Risk management**
- **Risk identification**

In order to develop a valuable internal control system the following elements must be in place, recognized, or utilized.

Risk management is the act or practice of controlling risk. Risk management is defined as all actions taken to identify, assess and eliminate or reduce risk to an acceptable level in selected areas (cost, schedule, technical, production); and the total program. Risk management activities fall into four broad elements and are performed with many standard feedback loops. The risk management process includes identifying and tracking risk areas, defining risk mitigation plans as part of risk handling, monitoring risks, and performing periodic risk assessments to determine how risks have changed and how to plan for adequate scheduling and resourcing.

Risk identification is the first step in the assessment process. The basic process involves searching through an entire program to determine those critical events that could prevent the program from achieving its objectives. We will discuss documentation of risk assessment in Lesson 3.

Now that we understand the keys to developing valuable internal control, let's discuss types of internal control.



**Internal control is a process, effected by management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:**

- **Effectiveness and efficiency of operations**
- **Reliability of financial reporting**
- **Compliance with applicable laws and regulations**

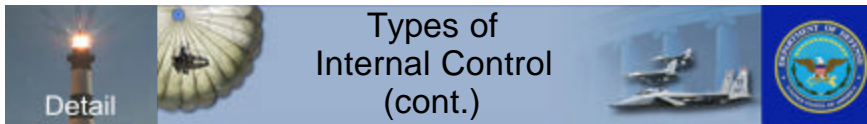
Internal control is a process, effected by management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations.

Without effective internal control, an organization may or may not be recording its transactions in a timely manner, or be able to rely on its reports to Congress, or be in compliance with governing laws.

A quote from an unknown source puts it succinctly, “Internal control is a tool to help ensure that what you want to happen, happens, and what you don’t, doesn’t.”

Let’s discuss the types of internal control that combine to establish effective management controls across the government and its agencies.



### **Internal control types:**

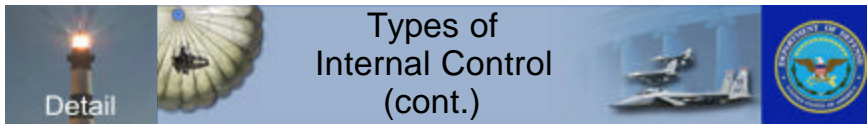
- **Managerial Control**
- **Program/Operational Control**
- **Accounting Control**
- **Financial Control**
- **Administrative Control**

Internal control is initiated, developed, implemented, and monitored at all levels of an organization, including managerial, operational, accounting, financial, and administrative. It varies in task and scope and addresses a myriad of issues that, without their application, may cause the erosion of public trust.

Distinction between types of control can be made in general terms to enhance understanding; however there are shades of gray between them tending towards an overlap in some cases. As activities within agencies are integrated, accounting, financial, and administrative control is required to head off fraud, waste, abuse, mismanagement, and misstatement of agency resources.

Misstatement is a relatively new addition to the list of possible misuses of organizational resources. The Sarbanes-Oxley Act (SOX) was written just to address the shortcomings of the creative uses of financial misstatements.

Lets take a look at each type of internal control, beginning with managerial control.



## **Managerial Control:**

**Includes overall policy, planning, organization, and internal review functions such as:**

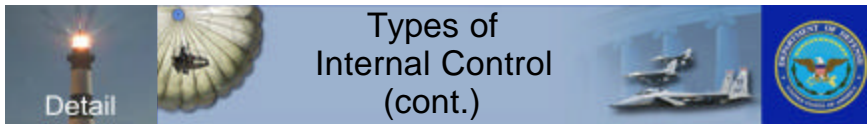
**Authorization and  
Access Restrictions**



**Timely Recording and  
Appropriate Documentation  
of Transactions and Internal  
Control**

Managerial control may include top level reviews of actual performance, establishment of performance measures, assessing personnel skill sets, designing training that is aimed at employee retention, and management oversight of internal control so that the control objectives are realized.

Our next internal control type covers the gamut of the day-to-day activities of an organization, program/operational control.



### **Program/Operational Control:**

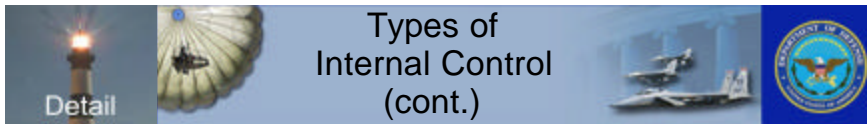
- **Involves those agency activities that relate to the mission or role of the agency/program**
- **Focuses on program performance and the economy and efficiency of operations**

Agencies must ensure that appropriate authority, responsibility, and accountability are defined and delegated to accomplish the mission of the organization. An appropriate organizational structure is established to effectively carry out program responsibilities.

Program/operational control ensures that each responsible layer in your organization knows what is required (through Standard Operating Procedures (SOPs) and directives) to ensure that the mission is effectively, efficiently and economically carried out.

To the extent possible, controls and related decision-making authority should be in the hands of line managers and staff. The ultimate control is you!

Now let's turn our attention to a control that has a telling effect on the management of our resources, accounting control.



### **Accounting Control:**

- **Relates to the safeguarding of assets and the reliability of financial reports. While emphasizing financial management, this control focuses on accountability and performance measures.**



- **Encompasses comparative data, performance measures, and indicators**



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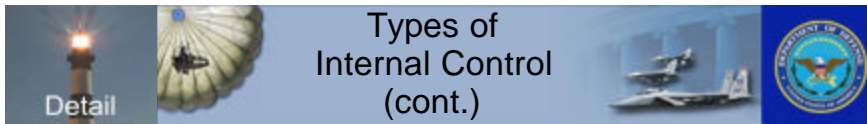
L1-18

Transactions and events should only be authorized by those people who have been given the authority. Access to certain funding documents and accounting records should be limited to those individuals authorized. Accountability related to these items must be assigned and maintained. Funding records must be checked to make sure that the accountable person has authorized their use.

It is necessary to record transactions in an accurate and timely manner in order to maintain their relevance and value to regulate the organization and decision-making activities. This is important throughout the lifecycle of all transactions as any gross deviation could distort financial data.

Transactions must be clearly documented, and the documentation must be available for examination. Internal control must be documented in management directives, administrative policies, or operating manuals. Comparative data, performance measures, and indicators are some of the quantitative and qualitative checks used to test these controls.

Let's discuss the next type of internal control, financial control.



### **Financial Control:**

- **Applies to those activities and processes involving the authorization and payment or collection of money**
- **Focuses on accountability for funds, authorizations, and safeguards**

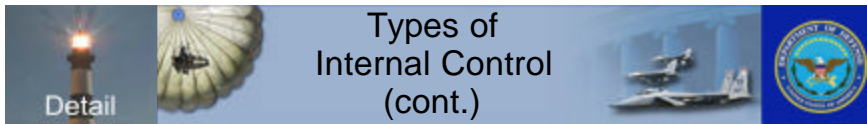


Financial control applies to those activities and processes involving the authorization and payment or collection of money. This control focuses on accountability for fund, authorizations, and safeguards.

Financial control may also include the establishment and review of performance measures and indicators allowing for a comparison and assessment of different sets of data so that analyses of the relationship can be made and, based on the results, the appropriate action taken.

The financial data is required for both internal and external use, for developing financial statements for external reporting, for making operating decisions, for monitoring performance and allocating resources, and should appear in a form that allows all personnel to effectively execute their missions.

Now let's discuss another control that covers every level of operations, administrative control.



### **Administrative Control:**

**Applies to those actions leading to the authorization of transactions and events based on compliance with established policies and procedures.**



**Information Systems**



**Segregation of Duties**

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Administrative control includes those actions leading to the authorization of transactions and events based on compliance with established policies and procedures. Particular to administrative control would be the control activities that are specific to information systems, such as general control and application control.

General control activities include entity-wide security program planning, management, control over data center operations, system software acquisition and maintenance, access security, and application system development and maintenance.

Application control is designed to help ensure the completeness, accuracy, authorization, and validity of all transactions during application processing.

Let's talk about the importance of internal control.





## Importance of Internal Control



**Effective internal control helps agencies execute missions and achieve program results. In other words, agencies are seeking ways to improve accountability, ensuring that:**

- **Data is valid and reliable**
- **Activities are economically and efficiently run**
- **Laws and regulations are followed**
- **Agency objectives are achieved and assets are safeguarded**

As the public demands for increased and improved accountability for use of taxpayer dollar escalates, so has the emphasis on effective internal control. Effective internal control ensures the public that data is valid and reliable, and activities are economically and efficiently run. It ensures that laws and regulations are being followed, agency objectives are achieved, and assets are safeguarded.

The benefits of effective internal control processes are improved controls, quick recognition of serious problems (material weaknesses), identification of problems at the lowest level, and minimization of potentially dangerous situations.

A lack of effective internal control can lead to public embarrassment and impact our ability to obtain funds to carry out our mission. Effective internal control guarantees the means to accomplish our missions within our budgeted resources.

Although internal control provides numerous benefits, it does have limitations.



## Importance of Internal Control (cont.)



### Limitations

**Internal control only provides reasonable assurance,  
not absolute assurance, because of the human factor.**

The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived. It recognizes that the evaluation of costs and benefits requires estimates and judgments by management.

There are life-cycle costs and benefits of internal control. Management must consider all ramifications.

Human mistakes, errors in judgment, and acts of collusion to avoid controls can affect agency objectives.

As we mentioned earlier, risk drives internal control development, either to recognize its existence or to thwart risk's effects. As part of the Government Performance and Results Act (GPRA), agencies must use internal control to mitigate possible risk from within and outside of an organization, and make a determination on how to address those risks. In order to assess those risks, agencies must have clear control objectives and ask if there are relevant risks associated with achieving those objectives.

Now that we have discussed the importance of internal control, let's continue with how internal control relates to financial reporting.



## Relationship of Internal Control and Risk to Financial Reporting



**“No money shall be drawn from the Treasury, but in consequence of appropriations made by law; and a regular statement and account of receipts and expenditures of all public money shall be published from time to time.”**

**Article 1, Section 9, Clause 7, United States Constitution**

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What is the basis of financial reporting? The accountability clause of the United States (U.S.) Constitution (Article I, Section 9, Clause 7) links the legal expenditure of appropriations to the reporting of transaction information and account balances. What this means to you is that there is a long history for the requirement to report on the use of resources. Until 1990, that reporting did not receive an audit.

From our financial report we must be able to trace the reported information back to sets of source documentation, defined as original documentation that supports a transaction. In the case of an audit, a select group of transactions is tested to verify accuracy, validity, legality of the transactions and supporting procedures, and adequate documentation with supporting signatures.

Once the sample financial information has passed the testing process, then we can say that our internal control program has been successful in mitigating risk associated with financial reporting.

Our goal is an unqualified (clean) audit opinion.

Let's discuss the Federal Manager's Financial Integrity Act (FMFIA) and OMB requirements next.



## FMFIA and OMB Requirements



### **Federal Managers' Financial Integrity Act (FMFIA)**

**Agencies must establish a process that includes:**

- **Effective internal control**
- **Internal control evaluations being performed regularly to ensure that controls are effective**
- **An annual Statement of Assurance that provides accountability at the agency head level**

Internal control is mandated by an Act of Congress, the FMFIA. It provides for effective internal control, regular internal control evaluations, and annual certification.

In particular, the FMFIA overall process pertains to establishing and assessing internal control for all program, operational, and administrative controls; establishing and assessing internal control over financial reporting; and reporting reasonable assurance over internal control, including identifying any material weaknesses during the assessment with the plans and schedules to promptly correct them and ensuring that the internal control is achieving its intended objectives.

OMB Circular A-123, Appendix A requires a statement of assurance on the effectiveness of internal control over financial reporting from entities that are required by OMB to produce stand-alone financial statements. (The DoDD 5010.38, DoDI 5010.40, and MIC Program Annual Guidance is covered in Lesson 6.)

Next let's delve into the OMB requirements.



## FMFIA and OMB Requirements (cont.)



**The primary OMB documents covering internal control requirements are:**

- **OMB Circular A-123, Management's Responsibility for Internal Control**
- **OMB Circular A-127, Financial Management Systems**
- **OMB Circular A-130, Management of Federal Information Resources**

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The Department must report information consistently in accordance with OMB Circular A-123, Management's Responsibility for Internal Control, which incorporates Section 2 of the FMFIA, and OMB Circular A-127, Financial Management Systems, which incorporates Section 4 of the FMFIA. Issuance of these reports in an accurate and timely manner will ensure that applicable information is available to echelons concerned that your agency's controls are achieving their intended objectives and your financial management systems conform with government-wide requirements. And if not, then the reports state what you plan to do to remedy the deficiencies. The OMB requirements for internal control are found in a number of OMB Circulars, A-123, A-127, and A-130.

The latest OMB Circular A-123 was initiated in light of the new internal control set forth in the Sarbanes-Oxley Act, CFO Council, and the President's Council on Integrity and Efficiency (PCIE) recommendations. It states that the Integrity Act encompasses program, operational, and administrative areas, as well as accounting, financial, and management issues, and prescribes the policies and standards for evaluating, improving, and reporting on internal control (formerly management control).

OMB reissued Circular A-127, which prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems.

OMB reissued Circular A-130, which provides uniform government-wide information resources management policies as required by the Paperwork Reduction Act, as amended.

Let's move on to the definitive GAO and OMB standards.



## GAO and OMB Standards



**The five GAO and OMB internal control standards are:**

- **Control Environment**
- **Risk Assessment**
- **Control Activities**
- **Information and Communications**
- **Monitoring**

**These standards mirror the components of internal control.**

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Effective Internal Control for Financial Reporting

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The five internal control standards as identified by GAO and OMB are:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring.

These standards define the minimum level of quality acceptable for internal control in government and provide the basis against which internal control is evaluated. They apply to all aspects of an agency's operations: program, finance, and compliance. They are not intended to limit or interfere with their own authority that originated from legislation and carried out through policy implementation under their regulations and SOPs.

These standards provide general guidelines to management and by proxy to you. To execute them, you must develop and follow detailed policies, procedures, and practices that ensure internal control is part and parcel of your agency's operations.

Let's continue with a detailed look at each at each internal control standard, beginning with Control Environment.



## GAO and OMB Standards (cont.)



### Control Environment

**The control environment is the organizational structure and culture created by management and employees to sustain support for internal control.**

### Risk Assessment

**Management should identify internal and external risks that may prevent the organization from meeting its objectives.**

The control environment is the organizational structure and culture created by management and employees to sustain support for internal control. You must have a positive and supportive attitude toward internal control and a conscientious work ethic at all levels. Your management should convey the message that integrity and ethical values must not be compromised.

Your entity must demonstrate a commitment to the competence of its personnel and employ good human capital policies and practices. The philosophy and operating style of your organization must be appropriate to the development and maintenance of effective internal control. A well designed structure and a transparent process for the delegation of authority/responsibility will enhance your internal control.

When employing risk assessment, the agency establishes clear and consistent entity-wide objectives and supporting field level objectives. Management makes a thorough identification of risks, from both internal and external sources, that affect the ability of the agency to meet those objectives. An analysis of those risks is performed, and the agency develops an appropriate approach for risk management. Mechanisms are in place to identify changes that affect the agency's ability to achieve its missions, goals, and objectives.

The control activities that an agency implements to reduce risk follow.



## GAO and OMB Standards (cont.)



### **Common categories of control activities:**

- Top level reviews
- Management reviews
- Management of human capital
- Information processing
- Physical control over vulnerable assets
- Access restrictions to and accountability for resources and records
- Performance measures and indicators
- Segregation of duties
- Execution of transactions and events
- Recording of transactions and events
- Documentation

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Internal control activities include policies, procedures, and mechanisms in place to help ensure that agency objectives are met.

Internal control activities must be developed and implemented to ensure adherence to established directives. You must ensure proper control activities have been developed for each of the your agency's activities. You must ensure that the control activities identified as necessary are actually being applied properly.

Without management's serious reliance on control activities to reinforce its modeling of control environment to its employees across all operations, its financial reporting may appear weak or flawed to auditors.

Let's discuss the fourth standard, Information and Communications.





## GAO and OMB Standards (cont.)



### **Information and Communications**

**Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities. Information and Communications includes:**

- **Information from internal and external sources**
- **Effective internal and external communications**
- **Forms and means of communications**

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Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities. Information and Communications includes information from internal and external sources, effective internal and external communications, and forms and means of communications.

Information systems are in place to identify and record pertinent operational and financial information relating to internal and external events. That information is communicated to management and others within the agency who need it, and in a form that enables them to carry out their duties and responsibilities efficiently and effectively.

Management ensures that effective internal communications take place. It also ensures that effective external communications occur with groups that can affect the achievement of the agency's missions, goals, and objectives.

The agency employs various forms of communications appropriate to its needs and manages, develops, and revises its information systems in a continual effort to improve communications.

Now let's look at internal control monitoring.



## GAO and OMB Standards (cont.)



### Monitoring

**Internal control monitoring should assess the quality and performance over time and ensure that the findings of audits and other reviews are promptly resolved.**

**Monitoring includes:**

- **On-going monitoring**
- **Separate evaluations**
- **Audit resolutions**

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Agency internal control monitoring assesses the quality of performance over time. It does this by putting procedures in place to monitor internal control on an ongoing basis as a part of the process of carrying out its regular activities.

It includes ensuring that managers know their responsibilities for internal control and control monitoring. In addition, separate evaluations of internal control are periodically performed and the deficiencies found are investigated.

Procedures are in place to ensure that the findings of all audits and other reviews are promptly evaluated, decisions are made about the appropriate response, and actions are taken to correct or otherwise resolve the issues promptly.

Let's review what we've covered in this lesson.



## Lesson Summary



- **Internal Control Overview**
- **Management's Responsibility**
- **Keys to Developing Valuable Internal Control**
- **Types of Internal Control**
- **Importance of Internal Control**
- **Relationship of Internal Control and Risk to Financial Reporting**
- **FMFIA and OMB Requirements**
- **GAO and OMB Standards**

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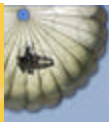
In this lesson, you learned internal control terminology and how an effective and efficient internal control system will serve as a basis for an organization to achieve an unqualified assurance. Management responsibility does not just come from the top but valuable input comes from the field to gauge how well internal control works and does it address those issues that they were designed to affect.

Internal control does not come in one color, it comes in shades of gray with the overlap of internal control types, for example, systems and information control has application across the complete internal control spectrum.

After delving into the descriptions, definitions, and types of internal control, we finally discussed its importance, from accountability to safeguarding assets. We also discussed the requirements and standards that provide the legal basis for internal control.

In the next lesson we'll cover process flows and lines of materiality.

The following slide lists references available for additional information.



## References



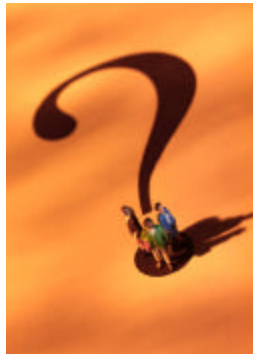
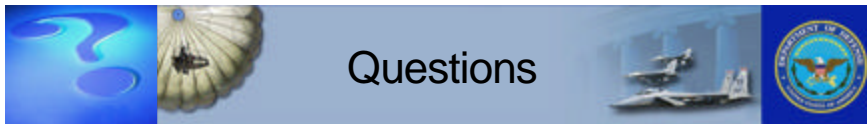
**GAO/PCIE FAM:** <http://www.gao.gov/special.pubs/gaopcie/>

**GAO Standards for Internal Control in the Federal Government:** <http://www.gao.gov/special.pubs/ai00021p.pdf>

**Checklist for Reviewing Systems under the FFMIA:**  
<http://www.gao.gov/new.items/d05225g.pdf>

**Internal Control, Comptroller's Handbook:**  
<http://www.occ.treas.gov/handbook/intcntrl2.pdf>

**DSMC Risk Management Guide for DoD Acquisition:**  
[http://www.mitre.org/work/sepo/toolkits/risk/references/files/DSMC\\_RiskMgmt\\_Guide.pdf](http://www.mitre.org/work/sepo/toolkits/risk/references/files/DSMC_RiskMgmt_Guide.pdf)



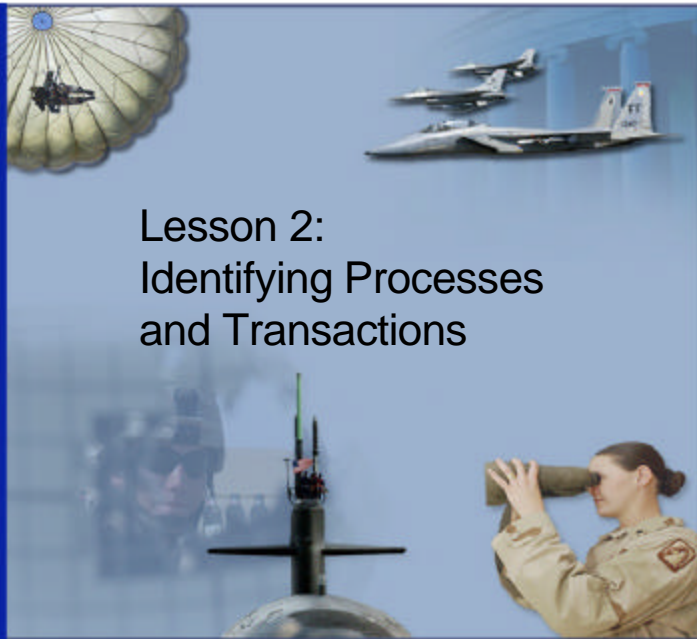
Before we move on Lesson 2, Identifying Processes and Transactions, do you have any questions on the material covered in this lesson?

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Effective  
Internal  
Control  
for Financial  
Reporting



Lesson 2:  
Identifying Processes  
and Transactions



In Lesson 2, we explore process flows and how analysis of a process assists us in determining internal control requirements. We will also identify and evaluate materiality with specific reference to some of the current weaknesses, to include Real Property, Military Equipment, Environmental Liabilities, and Fund Balance With Treasury (FBWT).

Let's discuss the lesson objectives.



## Lesson Objectives



**Upon successful completion of this lesson, you will be able to:**

- **Identify material lines, accounts, and significant transactions**
- **Identify key business processes**

This lesson will explain how to identify your material lines and accounts, and the significant transactions that impact your key business processes and reports which feed into the financial statements of your entity.

This is important because without the ability to identify and break down your business processes, you would be unable to effectively employ internal control to mitigate the risks associated with your day to day business practices. On the other hand, the ability to recognize the materiality of lines and accounts on your financial reports, and significant accounts, provides the starting point for examining the audit trail to find the root cause of a material weakness.

Let's look at the topics supporting these objectives.





## Lesson Topics



**This lesson contains the following topics:**

- **Evaluating Lines for Materiality**
- **Process Flows to Document Business Processes (with some examples using):**
  - **Military Equipment**
  - **Real Property**
  - **Environmental Liabilities**
  - **Fund Balance With Treasury (FBWT)**

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This lesson contains the following topics: Evaluating Lines for Materiality, and Process Flows to Document Business Processes with some examples of Real Property, Military Equipment, Environmental Liabilities, and FBWT.

Let's look at how to evaluate lines for materiality.



## Evaluating Lines for Materiality



### Annual Financial Statements

- **Management Discussion and Analysis**
- **Principal Statements and Related Notes**
  - **Balance Sheet**
  - **Statement of Net Cost**
  - **Statement of Changes in Net Position**
  - **Statement of Budgetary Resources**
  - **Statement of Financing**
  - **Statement of Custodial Activity**
- **Required supplementary information, if applicable**
- **Other accompanying information, if applicable**

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In order to cover material lines and significant accounts adequately we must examine the financial statements. The financial statements are a picture of the financial position of an entity as of a point in time.

Various entities within the Department prepare financial statements that are consolidated quarterly. The Department of Defense (DoD) Consolidated Financial Statements as of the end of the fiscal year, September 30, are published in the annual Performance and Accountability Report (PAR). The financial statements are preceded by Management Discussion and Analysis in which management provides an overview of the scope of its operations, provides a report on their internal controls and conformance to financial systems requirements, and discusses any issues that may be important to users of the financial statements. The statements are followed by required supplementary stewardship information and other required supplementary information.

The principal statements include the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, Statement of Financing, Statement of Custodial Activity, and if applicable, Notes to Principal Statements.

During an audit, amounts shown on the financial statements are verified through an examination of sample data and other evidence to ensure the reliability of the reported information.

Let's begin with a look at the Balance Sheet.



## Evaluating Lines for Materiality (cont.)



- **Assets**
- **Liabilities**
- **Net Position**
- **Previous year comparison**

Department of Defense Agency Wide Consolidated Balance Sheet As of September 30, 2004 and 2003 (\$ in Millions)	2004 Consolidated	2003 Consolidated Restated
<b>ASSETS (Note 2)</b>		
Intra-governmental:		
Fund Balance with Treasury (Note 3)	\$ 287,685.5	\$ 251,544.1
Total Intra-governmental Assets	\$ 522,798.8	\$ 458,609.6
Cash and Other Monetary Assets (Note 7)	2,178.1	1,534.9
<b>Inventory and Related Property (Note 9)</b>	<b>213,219.4</b>	<b>205,544.6</b>
General Property, Plant and Equipment (Note 10)	440,898.6	446,308.9
<b>TOTAL ASSETS</b>	<b>\$ 1,208,486.2</b>	<b>\$ 1,141,309.3</b>
<b>LIABILITIES (Note 11)</b>		
Intra-governmental:		
Accounts Payable (Note 12)	\$ 13,207.1	\$ 10,538.7
Mil Retirement/Emp -Related Actuarial (Note 17)	28,309.0	27,863.8
<b>TOTAL LIABILITIES</b>	<b>\$ 1,710,113.6</b>	<b>\$ 1,559,638.5</b>
<b>NET POSITION</b>		
Unexpended Appropriations (Note 18)	\$ 243,813.9	\$ 218,869.5
<b>Cumulative Results of Operations</b>	<b>(745,441.3)</b>	<b>(637,198.7)</b>
<b>TOTAL NET POSITION</b>	<b>\$ (501,627.4)</b>	<b>\$ (418,329.2)</b>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 1,208,486.2</b>	<b>\$ 1,141,309.3</b>

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The Balance Sheet lists the assets, liabilities, and net position of the entity. Assets represent the value of items an organization has in its control. These items are the resources the organization needs to accomplish its mission. Liabilities represent the amount an organization owes to its creditors. These items are the creditors' claims against the assets of the organization. The Net Position represents the worth of the owners investment in an organization. These are the owner's claim against the assets of the organization.

Management uses a Balance Sheet to compare the activity of their organization as represented by the amounts shown as assets, liabilities, and net position from one point in time to another. They are interested in changes in amounts attributable to changes in known activity. Any changes to amounts that are not explained by changes in known activity are areas of concern for management as they may be a result of recording or reporting errors, fraud, or mismanagement.

In evaluating a line for materiality, think about the significance of the amount reported within that line to the overall activity represented by the financial statement. The formula used by the DoD Office of the Inspector General (DoD OIG) auditors to evaluate materiality of a particular line is 1% of the activity base. The activity base is calculated by subtracting the Total Intra-governmental Assets from the Total Assets. Management must set its materiality base at less than that required by the auditor. For the Statement of Assurance on Internal Controls over Financial Reporting, the DoD uses .99% of Total Assets less Total Intergovernmental Assets.

Amounts shown on the Balance Sheet are comprised of several United States Government Standard General Ledger (USSGL) account balances or are the amounts transferred from related financial statements. Let's examine what is material in the eyes of the Financial Audit Manual (FAM) and the DoD OIG.



## Evaluating Lines for Materiality (cont.)



### What is material?

- **The FAM suggests a guideline for overall materiality is 3% of your materiality base**
- **The guideline for design, test, or account materiality is 1% of that base**
- **The materiality base the DoD OIG currently uses is total assets minus intragovernmental assets**
- **Total misstatements on a financial statement cannot exceed overall materiality**

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Total Assets 1,208,486.2 – Intragovernmental Assets 522,798.8 = 685,687.4 x .03 =  
Materiality Base 20,570.6 x .01 = Materiality 205.7 million per account or line.

The FAM and the DoD OIG provide these guidelines, but you also must be aware that an immaterial omission on, for example, accounts payable, combined with omissions or misstatements from other accounts on the balance sheet, could be material in total. The formula breaks out to:

Total Assets – Intragovernmental Assets x .03 = Materiality Base  
Materiality Base x .01 = Materiality per Account or Line

When the auditors know that an omission or misstatement has occurred, you need to have records of the omissions and misstatements on hand at the time of the audit. If they don't have that information, then they have to disclaim an opinion because the amount of misstatement is unknown.

Let's discuss types of General Property, Plant, & Equipment (PP&E), as it relates to materiality and reporting.



## Evaluating Lines for Materiality (cont.)



### **Types of General Property, Plant, & Equipment (PP&E):**

- **Real Property**
  - Lands and improvements
  - Buildings and structures
  - Installed equipment
  - Construction-in-progress (CIP)
- **Military Equipment**
  - Weapons systems
  - Support PP&E
  - Vessels in preservation status
- **Capital leases**
- **Leasehold improvements**
- **Asset owned in by an entity possession of others**
- **Land in connection with the construction of PP&E**
- **Land rights**

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Effective Internal Control for Financial Reporting

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Types of General PP&E include Real Property, Military Equipment, capital leases, leasehold improvements, assets owned by an entity in the possession of others, and land (other than Stewardship Land) in connection with the construction of General PP&E, and land rights. Items of General PP&E are combined when reported on the Balance Sheet, while Note 10 in the financial statements provides the detail for the reporting of the various categories of property and equipment. When reporting on Real Property, you are concerned with the General PP&E line as well as the USSGL accounts that provide information that is consolidated within Note 10.

Real Property consists of land and improvements to land; buildings and structures, including improvements, additions, and Construction-In-Progress (CIP); and utilities. It includes installed equipment built into a facility as an integral part of the facility (such as heating systems), but not movable equipment (such as plant equipment). In many instances, this term is synonymous with real estate.

Let's examine Note 10.



## Evaluating Lines for Materiality (cont.)



### General PP&E

Note 10. General PP&E, Net						
As of September 30	2004	2003				
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	(91,463.2)	67,983.7	76,386.0
C. Leasehold Improvements	S/L	lease term	139.1	(96.3)	42.8	96.2
D. Software	S/L	2-5 Or 10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,386,610.3	\$ (947,711.7)	\$ 440,898.6	\$ 446,308.9
* See Note 15 on Capital Lease Liability for additional information						
Legend for Valuation Methods:						
S/L = Straight Line N/A = Not Applicable						

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On Note 10, General PP&E, Net, there are major asset classes. Real Property includes amounts listed in the following classes:

- Land, Buildings, Structures, and Facilities
- Leasehold Improvements (if the property under lease is categorized as Real Property)
- Software
- General Equipment, Military Equipment
- Assets Under Capital Lease (again if the property is classified as Real Property)
- CIP.

Land and facilities such as buildings and structures are considered tangible assets used by an entity and have a useful life of at least two years. If their acquisition cost equals or exceeds the DoD capitalization threshold (\$100,000), they are capitalized and depreciated. Has this been the case in your activity?

When computing depreciation, buildings, facilities, and structures do not have a salvage value. The recovery period for buildings, hangars, warehouses, fuel storage buildings, air traffic control towers, and other Real Property buildings is 40 years. These assets are recorded in property accountability and/or accounting systems, assigned a dollar value, and supported by documentation such as contracts, receiving reports, work orders, or construction contractors. This documentation (original documents and/or hard and electronic copies of original documentation) should be maintained in a readily available location during the applicable retention period, to permit the validation of information pertaining to the asset, such as the acquisition cost, the acquisition date, and the cost of any improvements. What is the status of your documentation?

The Other Structures and Facilities Account is used to account for DoD-controlled utilities and improvements to land, and facilities not classified as buildings. Property records provide an audit trail of the transactions suitable for audit.

We discussed buildings, other structures, and facilities. Now let's discuss the documentation of your business processes.



## Process Flows to Document Business Processes



**Cycle memos document business processes and should:**

- **Identify transactions, accounting applications, and financial management systems**
- **Describe interfaces with other cycles**
- **Identify financial statements line items and general ledger accounts**
- **Describe policies and procedures**
- **Identify internal control**

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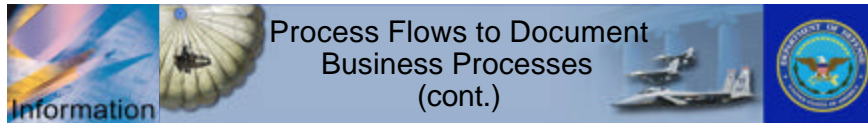
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A common procedure used to document business processes is the preparation of a cycle memo. A cycle memo is a narrative representation of the sequence and content of your business process. It explains what comes first, second, third, as well as documents prepared or received and actions taken by personnel within an organization. In addition, flow charts are prepared to complement the narrative descriptions in the cycle memos.

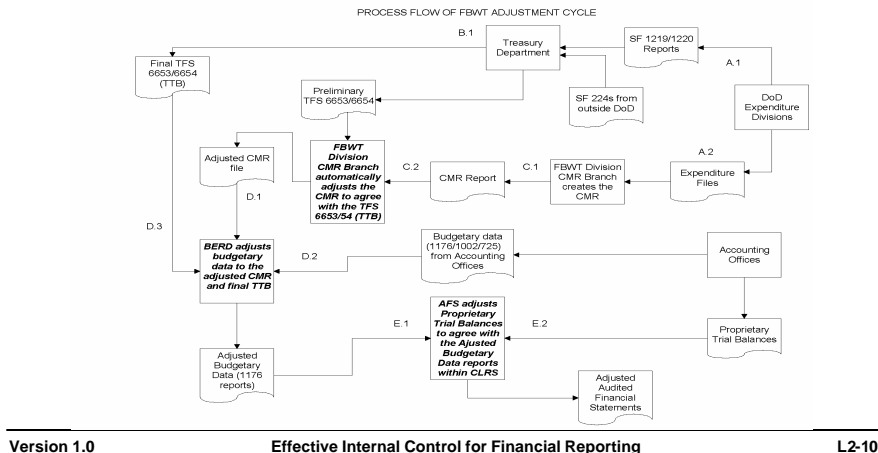
According to the Government Accountability Office/President's Council on Integrity and Efficiency Financial Audit Manual (GAO/PCIE FAM), the cycle memorandum should identify the cycle transactions, each significant accounting application, and each significant financial management system included in the cycle. The cycle memorandum should also describe interfaces with other cycles, identify financial statements line items and general ledger accounts included in the cycle. The cycle memorandum should also describe the operating policies and procedures relating to the processing of cycle transactions, and identify major internal controls. Instructions for cycle memorandums are located in Appendix B of the Student Guide.

It is important to be familiar with the process of preparing a cycle memo, so let's look at the components of the cycle memo.



## Cycle memos include cycle interfaces and line items.

Purpose: To consolidate individual flowcharts to describe the FBWT Adjustment process.  
Source: Shaun Pickering, Team Lead Assistant, (616) 528-5523, worksheet B.2.150



The components of a cycle memo include the cycle narrative, cycle interfaces, and financial statements line items containing general ledger accounts included in the cycle.

Within the cycle narrative, you may include a description of the operating policies and procedures that relate to the processes to ensure that necessary actions are taken to address risks, internal control procedures, known risks and potential weaknesses, activities designed to monitor those risks, and a recap of previous audit results.

Flow charts are used to provide a graphic description of the points at which your processes interface with other cycles. They also depict systems inputs, decision points, and outputs.

You should identify the financial statements line item or items and the general ledger accounts included in the cycle.

Let's continue with a description of the policies and procedures that are a part of the cycle narrative.





## Process Flows to Document Business Processes (cont.)



### **Policies and procedures should include:**

- **An explanation of how policies and procedures are communicated to employees (in the form of policies and manuals)**
- **The process by which documents flow through the organization in order to properly record, process, summarize, and report**

The description of the policies and procedures should include an explanation of how policies and procedures are communicated to employees (in the form of policies and manuals) and the process by which documents flow through the organization in order to properly record, process, summarize, and report.

Examples of these processes should include how the agency:

- initiates transactions
- identifies and records all valid transactions
- classifies transactions
- measures values
- uses and stores source documentation
- records transactions in the proper time period
- presents and discloses transactions
- communicate roles and responsibilities of employees
- uses computer systems to access, update, and delete files.

Now let's talk about the part internal control plays in the cycle memo.



## Process Flows to Document Business Processes (cont.)



**The cycle memo internal control portion should discuss:**

- **Control objectives and their relationship to assertions**
- **Performance reviews (such as the analysis of actual performance, as opposed to budgeted performance)**
- **Information processing controls that monitor accuracy, completeness, and authorization of transactions**

You must identify internal control in the cycle memo by discussing control objectives and their relationship to assertions; performance reviews (such as the analysis of actual performance, as opposed to budgeted performance); and information processing controls that monitor accuracy, completeness, and authorization of transactions.

These information processing controls include agency access to assets and recorded accountability of assets as compared to what actually exists. Appropriate action taken with respect to differences is also included. The recording of transactions as authorized by management and in conformity with Generally Accepted Accounting Principles (GAAP) are included. Information processing controls also require activities to ensure physical security of assets or records, periodic counts, and reconciliations. Segregation of duties and accessing control techniques, such as performing walkthroughs, and follow-up are necessary.

Let's consider the remaining components of the cycle narrative.



## Process Flows to Document Business Processes (cont.)



### **Components of the cycle narrative should include:**

- **Known risks and potential weaknesses**
- **Agency monitoring activities**
- **Recap of prior audit results**

You must describe, in detail, any known risks and potential weaknesses, and their effect on the financial statements, by identifying control objectives designed to prevent or detect the misstatements.

You must describe the agency's monitoring activities. Monitoring activities include internal auditors or other personnel who have communications about strengths, weaknesses, and recommendations for improving internal control; and ongoing supervisory monitoring activities.

The use of prior audit results also assists in the cycle memo narrative development. The processes described within the cycle memo can be detailed and difficult to understand. Flow charts that help explain the process can be used to reinforce the narrative of the cycle memo.

Let's look at how flow charts are used.



## Process Flows to Document Business Processes (cont.)



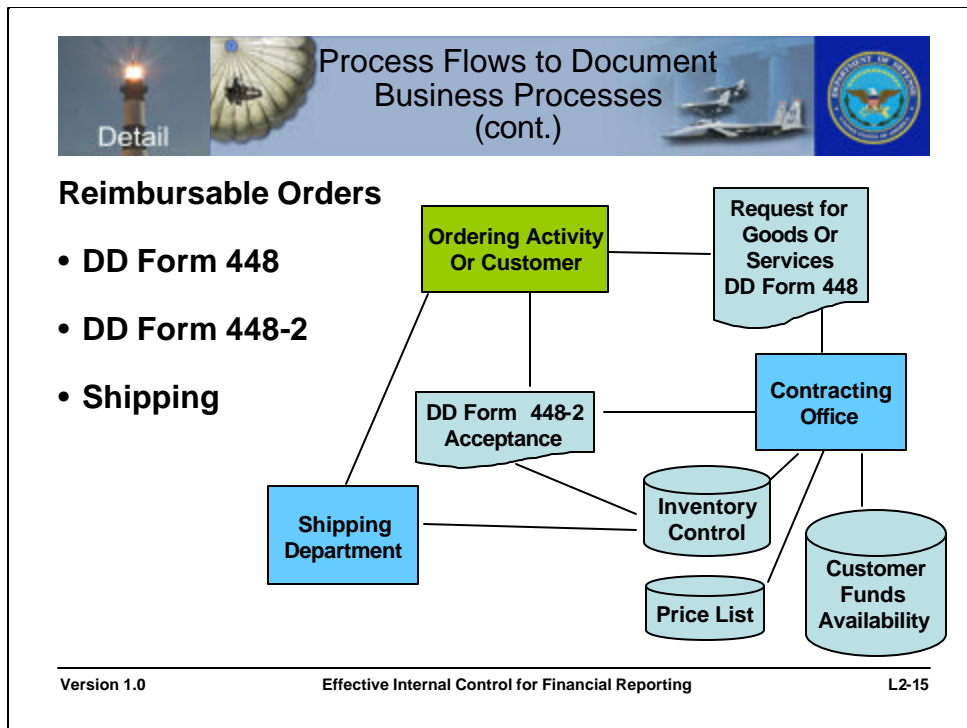
**Flow charts must summarize the flow in terms of:**

- **Systems inputs and reports**
- **Processing steps**
- **Files used**
- **Units involved**
- **Interfaces with other cycles and applications**

The flow chart must summarize the flow in terms of input and report documents, processing steps, files used, units involved, and interfaces with other cycles and applications.

Examples of cycles are: Accounts Receivable, inventory, property, liabilities, revenue, expenses, obligations, and many others.

Let's take a look at an example of how a reimbursable process may be depicted in both narrative and flow chart form.



The next slides provide the analyses of business processes that involve sales and resultant cash receipts, and the break down of the internal control applied to the process flows.

Reimbursable orders controls begin with the initial customer order, which is the Request for Goods or Services. Orders should be compared to an approved customer file. If the customer is not listed or is in some way impaired due to insufficient fund availability, then approval for the transaction should be referred to a supervisor or someone authorized to approve the transaction. Upon approval, a sales order is prepared or may be sent from an existing customer. This document is the start of the transaction trail of documentary evidence to support the receivable.

The approval should be based on criteria established by management that considers the funds availability of the customer and the availability of resources of the selling activity. The separation of duties for the approval of the Department of Defense (DD) Form 448, Military Departmental Purchase Request (MIPR) and the contracting staff reduces the risk of initially recording a reimbursable in excess of the amount of cash expected to be realized from the transaction.

The prohibiting of the release of goods from a warehouse without an approved DD Form 448-2, Acceptance of MIPR contributes to the physical controls over the assets of your entity. The approved sales order file also supports the inventory control records.

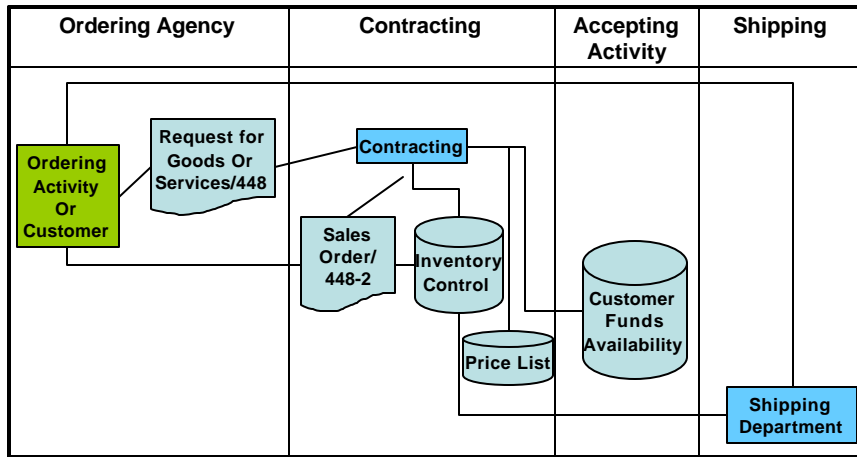
Now let's see how this flow chart looks in the preferred Office of the Under Secretary of Defense (Comptroller) OUSD(C) "swim lane" format.



## Process Flows to Document Business Processes (cont.)



### Flow Chart Example



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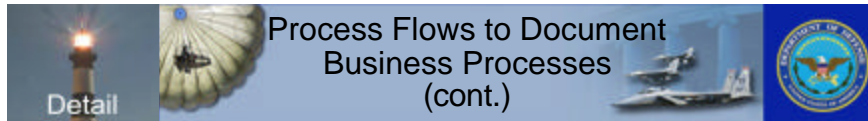
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This flow chart provides an example of the preceding flow chart in the preferred OUSD(C) "swim lane" format. Examples of this format will be found in the Guidelines for Preparation of the FMFIA Annual Statement Of Assurance.

Another form of the cycle memo is the Process Analysis Document (PAD) methodology.

Let's examine the criteria used to evaluate your cycle memos and flow charts.



### **Evaluation criteria for Process Cycle Memos and Flow Charts:**

- **Accurately describe the regulations followed for the process**
- **Document procedures utilized**
- **Document key control techniques**
- **Identify systems used at the departmental level**
- **Include the management control objectives and risk assessments**

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A flow chart is required for each major process to accurately describe regulations followed for the process, document procedures utilized, document key control techniques, identify systems used at the departmental level, and include the management control objectives and risk assessments.

Control techniques/activities are those activities that work to ensure that resources are used consistent with laws, regulation, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and disclosed in reports. Examples of control techniques/activities include passwords, separation of duties, physical security, and adequate supervision, among many others.

You should review the flow charts, cycle/process memorandum, and supporting documents for reasonableness and completeness for each process listed. Earlier in the course, a cycle memo was described in detail. You can refer to the GAO/PCIE FAM Section 390.04, Cycle Memorandum and Flow Chart, for further information on a cycle memorandum. Refer to Appendix B of the Student Guide for further information.

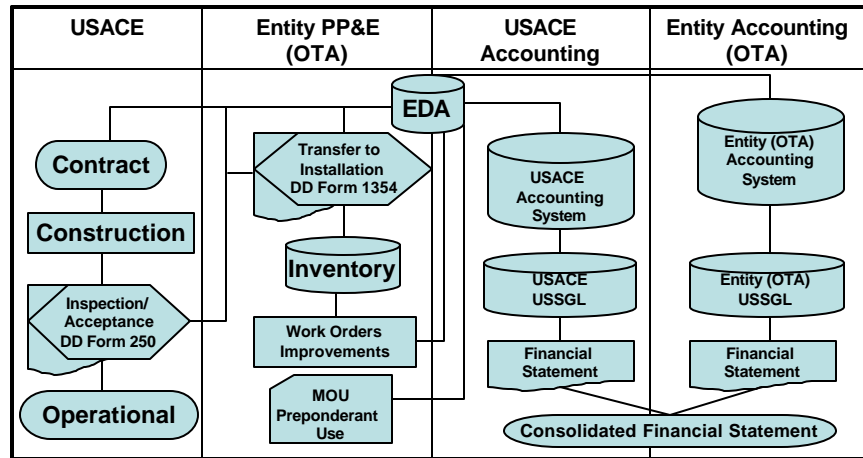
Let's consider an example of documents generated in a flow chart.



## Process Flows to Document Business Processes (cont.)



### Example of Documents Generated in Flow Chart



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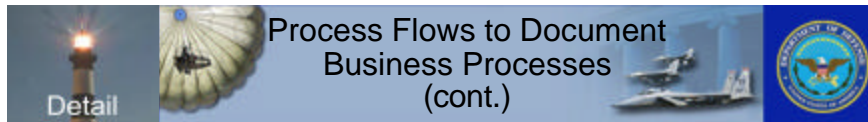
L2-18

Here is a flow chart examining the effect of a transaction and its related documentation and general ledger entries on the agency's financial statements. This example is a construction project initially managed by the U.S. Army Corps of Engineers (USACE) at a Military Installation other than Army.

This diagram depicts various interrelationships involved in developing and placing the building in operation. Each of these events requires appropriate documentation to support the resulting accounting transactions to be recorded in the general ledgers of the appropriate entity. It shows the capturing of the data at various levels until the information is summarized in the department's financial records.

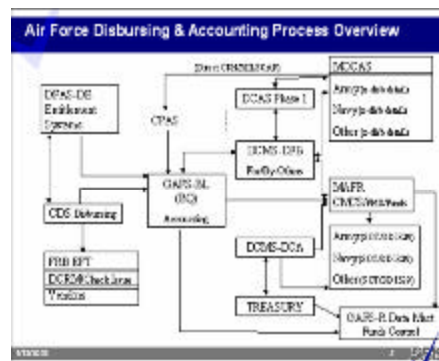
Let's take a quick look at the format of this method of presenting a processing cycle.





## Process Analysis Documents (PADs) contain five sections:

- Definition
- Process Operation
- Computer Information Systems
- Process-level Risks and Controls
- Acronyms



Computer Information Systems Example

<https://eportal.dfas.mil/>

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Depicted in this example is an Air Force Disbursing and Accounting Process Overview that represents one of several sections in a PAD. A PAD is another methodology used to analyze processes and their internal control. The purpose of it is to identify and document the processes and controls used by an organization. In a PAD you document how each key process operates and analyze specific risks and internal controls that are a matter of policy and procedure to safeguard against risk. A typical PAD consists of a scope and limitation narrative, and five additional sections which cover the definition, process operation, computer information systems, process-level risks and controls, and acronyms.

Section I, Definition, defines key words and the general processes. Section II, Process Operation, is a more detailed documentation of the individual processes. Section III, Computer Information Systems, gives a description of systems that are used in the process being analyzed and contains flow charts of operational concepts, functionality, system architecture, system inputs, and outputs. This slide shows a computer information systems example. Section IV, Process-level Risks and Controls, documents identified risks, the potential effect on financial statements, and controls that are in place to monitor and minimize the risks. Finally, Section V, Acronyms, includes all acronyms used in the analysis.

PADs are important when preparing for an audit, as they provide the auditors with a complete analysis of a process. Auditors readily review the process and determine areas that require testing. PADs show auditors that you understand the processes in your domain, understand their strengths and weaknesses, and have a plan to minimize risk.

Now let's discuss Military Equipment as depicted in Note 10 to the financial statements.



## Military Equipment



### Military Equipment

- **Weapons systems**
- **Support PP&E**
- **Vessels in preservation status**

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As was stated earlier, types of General PP&E include Real Property, Military Equipment, capital leases, leasehold improvements, assets owned by an entity in the possession of others, and land (other than Stewardship Land) in connection with the construction of General PP&E and land rights.

Military Equipment consists of components of weapons systems and support PP&E used by Military Departments in the performance of Military missions and vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet.

Military Equipment must be valued, and, if its value is above the DoD capitalization threshold, must be capitalized and depreciated. It is then reported on the Department's Consolidated Balance Sheet.

Audits have revealed that the Department is not reporting the cost of Military Equipment in accordance with GAAP, primarily due to the lack of historical cost information but there have been other issues, such as inventory control.

Let's consider the background of these two issues.



## Military Equipment (cont.)



**Capitalization threshold guidance was updated based on Statement of Federal Finance Accounting Standards (SFFAS) No. 23, Eliminating the Category National Defense PP&E.**

- **Treat Military Equipment as General PP&E in accordance with SFFAS No. 23, dated May 8, 2003**
- **Capitalize and depreciate the Military Equipment if it meet or exceeds the capitalization threshold of \$100,000**



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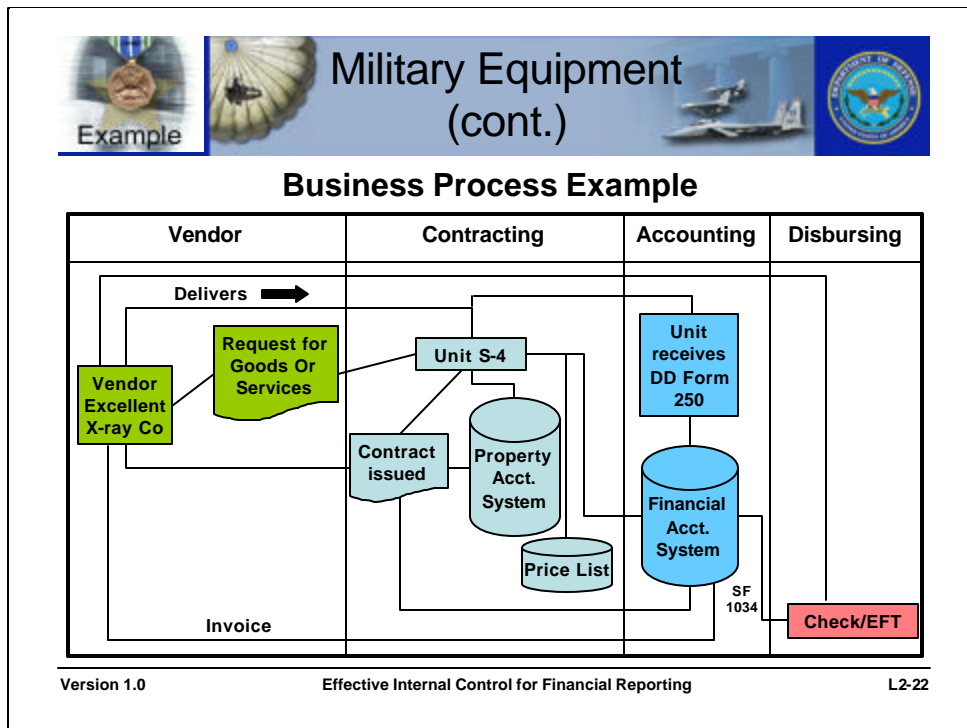
The first issue is the lack of historical cost information. The Statement of Federal Financial Accounting Standards (SFFAS) No. 23 eliminated the category National Defense (ND) PP&E and reclassified its items as General PP&E. This reclassification required the valuation of inventory items that had been previously expensed in the period incurred. Initial capitalization amounts for assets previously considered ND PP&E are now based on historical costs, including any major improvements or modifications. The capitalization threshold for Military Equipment is \$100,000.

It's understood that determining initial historical cost is difficult or even impossible for some items acquired many years ago when historical records were not required to be retained. So when initial historical costs can't be practically obtained, estimated historical costs are used. Other information may also be used as the basis for estimating historical cost such as budget, appropriation, or engineering documents and other reports reflecting amounts expended. Another alternative is to use estimates of historical costs by taking the current replacement costs of similar items and then deflating them through use of price-level indexes to the actual or estimated acquisition year.

Don't forget that accumulated depreciation should be calculated.

The Property and Equipment Policy (P&EP) Office, under the Director, Acquisition Resources and Analysis, OUSD Acquisition, Technology, and Logistics (AT&L), was established to coordinate and oversee Department efforts to resolve existing PP&E accountability, accounting, and reporting problems.

Now let's consider the inventory control issue to assess risk.



Inventories of General PP&E must be performed periodically, as outlined in the DoDFMR, Volume 4, Chapter 6, depending on the type of PP&E, of which Military Equipment is one type. The inventories are reconciled to the property accountability records and/or systems.

Accountability systems track the quantities of Military Equipment and may contain applicable depreciation schedules. They maintain the physical control documentation necessary to ensure positive tracking of all Military Equipment. Accounting systems are more concerned with the monetary values of the Military Equipment documented in the accountability systems. Presently, most accountability systems do not interface with accounting systems and information is transferred manually.

Inconsistencies may develop due to lack of training, lack of internal control, or lack of leadership. For example, a recent audit finding involved millions of dollars of excess materiel that accumulated because maintenance center personnel wanted to avoid the negative impact of writing off the excess inventory on the financial statements.

Let's look at a typical audit question used to evaluate your PP&E.



## Military Equipment (cont.)



### Military Equipment

223. For general PP&E previously considered national defense PP&E where obtaining initial historical cost is not practical, is estimated historical cost used, based on one of the following alternatives?

- a. current replacement cost of similar items, deflated through the use of price-level indexes to the acquisition year or estimated acquisition year if the actual year is unknown
- b. other information indicating amount expended, such as budget, appropriation, or engineering documents and other reports reflecting amounts expended
- c. other reasonable approaches for estimating historical cost<sup>28</sup> (SFFAS 23, par. 12 & 13)

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Question 223 of the GAO/PCIE FAM Checklist states:

For general PP&E previously considered national defense PP&E where obtaining initial historical cost is not practical, is estimated historical cost used, based on one of the following alternatives?

- a. current replacement cost of similar items, deflated through the use of price-level indexes to the acquisition year or estimated acquisition year if the actual year is unknown
- b. other information indicating amount expended, such as budget, appropriation, or engineering documents and other reports reflecting amounts expended
- c. other reasonable approaches for estimating historical Cost (SFFAS 23, Paragraphs 12 and 13).

Using this and other questions in the area of General PP&E, you may evaluate your reporting of Military Equipment to ensure that it is in accordance with the appropriate guidance.

Now let's discuss our next material line, Real Property.



## Real Property



**Capital leases that are classified as General PP&E and acquired by the DoD are considered either personal or Real Property. The Components are required to:**

- **Comply with guidance in the Department of Defense Financial Management Regulation (DoDFMR)**
- **Maintain documentation to identify and account for capital leases**
- **Record cost for capital leases including the cost at inception, plus any other consideration**
- **Depreciate the capital lease if it meets or exceeds the DoD threshold of \$100,000**

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General PP&E includes assets acquired through capital leases, including leasehold improvements. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee such as capitalization, clean-up costs, condition assessment surveys, cost objective, and deferred maintenance.

The criteria for identifying capital leases for financial reporting purposes differ from the OMB criteria for budget scoring of leases. The OMB provides for additional criteria which relates to the level of private sector risk involved in a lease-purchase agreement. These criteria are:

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life.
- The present value of rental and other minimum lease payments, excluding that portion of the payment representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels. The asset is depreciated if it meets or exceeds the DoD capitalization threshold, and the accumulated depreciation is accounted for in the Accumulated Depreciation on Assets Under Capital Lease Account.

Let's look at a breakdown of the Assets Under Capital Lease that are listed in Note 10.



## Real Property (cont.)



### Assets Under Capital Lease

- Capitalized if it meets or exceeds the DoD threshold of \$100,000
- Depreciated for the lesser of the remainder of the lease period or 20 years
- Capitalized assets are reported on the Department's financial statements

Assets Under Capital Lease			
As of September 30			
		2004	2003
(Amounts in millions)			
1. Entity as Lessee, Assets Under Capital Lease:			
A. Land and Buildings	\$	574.6	\$ 574.6
B. Equipment		11.3	2.6
C. Accumulated Amortization		(379.2)	(343.6)
D. Total Capital Leases	\$	206.7	\$ 233.6

Assets Under Capital Lease consist primarily of leases for the Section 801 Family Housing Program.

**Fluctuations**

Assets Under Capital Lease decreased \$26.9 million (12 percent). This change is due to normal depreciation expense in FY 2004.

**Other Disclosures**

Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases.

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Note 10, General PP&E, includes a breakdown of several of the amounts listed in the Major Asset classes. The Major Asset class, Assets Under Capital Lease, consists of Land and Buildings and Equipment. The Total Capital Leases line must agree with amount listed under the associated Major Asset class, Assets Under Capital Lease.

The value of the improvements to leased property, as well as easements and rights of way, are capitalized if they meet or exceed the DoD capitalization threshold of \$100,000.

The recovery period is the remainder of the lease period or 20 years, whichever is less.

It is important to recognize the leasehold improvements, record them correctly, and depreciate them correctly, or it could adversely affect the accuracy of financial statements.

Now that we have discussed the details of Real Property listed in Note 10, let's look at the FAM Checklist items related to PP&E.



## Real Property (cont.)



### General PP&E

<i>General property, plant, and equipment (PP&amp;E) are any property, plant, and equipment used in providing goods or services. (SFFAS 6, par. 23)</i>		
187. Has the entity established, disclosed, and consistently followed appropriate capitalization thresholds for property, plant, and equipment (PP&E) suitable to its financial and operational conditions? (SFFAS 6, par. 13)		
188. Does the entity follow a policy that ensures its PP&E consists of tangible assets, including land, that meet the following criteria?  a. have estimated useful lives of 2 years or more  b. are not intended for sale in the ordinary course of operations  c. are acquired or constructed with the intention of being used or being available for use by the entity (SFFAS 6, par. 17)		

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Question 187 of the GAO/PCIE FAM Checklist states: Has the entity established, disclosed, and consistently followed appropriate capitalization thresholds for property, plant, and equipment (PP&E) suitable to its financial and operational conditions? (Statement of Federal Financial Accounting Standards (SFFAS) No. 6, Paragraph 13)

This is just one question addressing PP&E on the FAM checklist that your audit is to be based on. If the answer is no to any of the questions, what are you doing to correct the situation? Do you have a plan? What type of internal control is needed? If a plan exists, how must you change it to address the situation? Each reporting activity must respond in kind to its reporting requirements.

Let's discuss our next material line, Environmental Liabilities.





## Environmental Liabilities



**Environmental Liability – includes estimated amounts for the future cleanup of contamination resulting from waste disposal methods, leaks, spills, and other past activity that have created a public health or environmental risk**

- **Requirements and recognition**
- **Note 14**
- **Weaknesses**
- **Audit questions**

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Environmental Liabilities include estimated amounts for the future cleanup of contamination resulting from waste disposal methods, leaks, spills, and other past activity that have created a public health or environmental risk. Neither budget activity nor availability of funding is a determining factor in recognizing an Environmental Liability, and Environmental Liability estimates and reporting are mandatory regardless of whether the liability appears in budgets or requires future funding.

In talking about Environmental Liabilities, we discuss the requirements for cleanup of contamination and the recognition of liabilities associated with that cleanup or restoration on the financial statements. Environmental Liabilities are shown on Note 14 of the financial statements and the noted weaknesses in that reporting. We present a few audit questions for the evaluation of your Environmental Liabilities reporting.

Let's discuss the requirements for cleanup and the recognition of these costs.



## Environmental Liabilities (cont.)



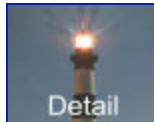
**The Department is required to cleanup contamination resulting from past waste disposal practices, leaks, spills, and other past activity, which have created a public health or environmental risk.**

- **Recognize closure and post-closure costs**
- **Track and report cost information**
- **Validate model estimates**

The Department is required to cleanup contamination resulting from past waste disposal practices, leaks, spills and other past activity, which have created a public health or environmental risk. This effort is accomplished in coordination with regulatory agencies, and if applicable, with other responsible parties and current property owners. The Department is also required to recognize closure and post-closure costs for its General PP&E and environmental corrective action costs for current operations. Each of the Department's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapons systems, and environmental costs related to the Base Realignment and Closures (BRAC) actions that have taken place in prior years.

Numbers reflected on the financial reports are the result of engineering estimates and independently validated models to estimate Environmental Liabilities. The models are contained within the Remedial Action Cost Engineering Requirements (RACER) and the Department of the Navy Normalization of Data System (NORM). The numbers should be validated in accordance with DoD Instruction 5000.61, DoD Modeling and Simulation (M&S) Verification, Validation, and Accreditation (VV&A). Entities use the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

Let's look at how these liabilities are reported on Note 14 on the financial statements.



## Environmental Liabilities (cont.)



### Note 14

#### NOTE 14: Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities

	Current	Non-Current	Total	PY FY
<b>1.B.1 DERP funded</b>				
• Active Installations - Environmental Restoration (ER)	XXXX	XXXX	XXXX	XXXX
• Active Installations - ER for Closed Ranges	XXXX	XXXX	XXXX	XXXX
• Formerly Used Defense Sites (FUDS) - ER	XXXX	XXXX	XXXX	XXXX
• FUDS - ER for Transferred Ranges	XXXX	XXXX	XXXX	XXXX
<b>1.B.2 Non-DERP funded (compliance-related cleanups)</b>				
• Active Installations - Environmental Corrective Actions	XXXX	XXXX	XXXX	XXXX
• Active Installations - Environmental Closure Requirements	XXXX	XXXX	XXXX	XXXX
• Active Installations - Environ. Responses at Active Ranges	XXXX	XXXX	XXXX	XXXX
• Other				
<b>1.B.3 BRAC funded</b>				
• BRAC Installations - Environmental Restoration (ER)	XXXX	XXXX	XXXX	XXXX
• BRAC Installations - ER for Transferring Ranges	XXXX	XXXX	XXXX	XXXX
• BRAC Installations - Environmental Corrective Action	XXXX	XXXX	XXXX	XXXX
• Other				
<b>1.B.4 Environmental Disposal for Weapons Systems Programs</b>				
<b>2. Total Environmental Liabilities</b>				
<b>3. Other Information Related to Environmental Liabilities (Footnote Narrative)</b>				

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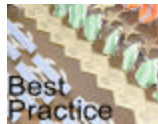
Note 14 reports environmental restoration and cleanup cost for active installations (Defense Environmental Restoration Program (DERP) and Non-DERP funded), Formerly Used Defense Sites (FUDS), and BRAC installations, as well as estimated costs for environmental disposal for weapons systems programs. Estimated costs are divided into those costs that will be incurred in the current period (within one year) and non-current costs. Costs are accumulated for each site and identified by program year.

Costs included in the non-current column should be based on the basis of cost estimates. Cost estimates refer to the future cleanup of environmental contamination (also includes response actions to address Unexploded Ordnance (UXO), Discarded Military Munitions (DMM), and Munitions Constituents (MC)) at past and present DoD sites. Cost estimates are an important planning tool in the budget process. They support Program Objective Memorandum (POM) submissions, and are used in the development of the President's budget. They are useful in tracking cost avoidance measures, and are required for financial reporting of Environmental Liabilities.

Cost estimates are an annual requirement of the Department and must comply with the DoDFMR for documentation of data sources, method of estimation, and documentation of managerial review.

An internal control methodology is standardization of reporting and costing basis which allows for consistent reports provided to outside entities (such as the DERP Annual Report to Congress), and consistent from the point of origin (installation) and throughout the chain of command. Reported cost estimates must have adequate supporting documentation, and that documentation must match what is in the data reporting system. Now you must flow chart and do a risk assessment as a result of analysis of your examination of your processes.

Let's explore the Environmental Liabilities reporting.



## Environmental Liabilities (cont.)



### Environmental Liabilities Reporting

345. If material, does the entity separately recognize a contingent liability for environmental clean-up costs <sup>35</sup> for PP&E if the following criteria apply?  a. they are related to a past transaction or event  b. the related costs are probable and measurable (SFFAS 5, par. 38 & SFFAS 6, par. 91-93; OMB Bulletin 01-09, pp. 25 & 26, section 3.4)		
346. When clean-up costs are paid, are the payments recognized as a reduction in the liability for clean-up costs? (SFFAS 6, par. 100)		
347. If clean-up costs have not been previously recognized, is a liability recognized for the portion of the estimated total clean-up cost that is attributable to either the portion of the physical capacity used or the portion of the estimated useful life that has passed since the PP&E was placed into service? (SFFAS 6, par. 104-106)		

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Again we address the FAM auditing questions in preparation for an audit of reportable Environmental Liabilities.

Question 345 addresses whether or not your entity separately recognizes a contingent liability for environmental cleanup costs for PP&E, if they are related to a past transaction or event or the related costs are probable and measurable.

Question 346 asks whether when cleanup costs are paid, are the payments recognized as a reduction in the liability for cleanup costs.

Finally, Question 347 asks if cleanup costs have not been previously recognized, whether or not a liability is recognized for the portion of the estimated total cleanup cost that is attributable to either: the portion of the physical capacity used; or the portion of the estimated useful life that has passed since the PP&E was placed into service.

You should attempt to determine the answers to these questions in assessing the effectiveness of your internal controls.

Let's move on to our final example, Fund Balance with Treasury (FBWT).



## Fund Balance With Treasury



**Fund Balance With Treasury – the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities.**

- **Includes clearing account balances and the dollar equivalent of foreign currency account balances**
- **From the reporting entity's perspective, it is an asset**
- **From the perspective of the federal government as a whole, it is neither an asset nor a liability; instead it represents a commitment to make resources available to federal departments, agencies, programs, and other entities**

### **SFFAS No. 1, Paragraphs 31 and 32**

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A federal entity's FBWT is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. FBWT includes clearing account balances and the dollar equivalent of foreign currency account balances.

From the reporting entity's perspective, an FBWT is an asset. From the perspective of the federal government as a whole, the fund balance is neither an asset nor a liability; instead it represents a commitment to make resources available to federal Departments, Agencies, Programs, and other entities. (SFFAS No. 1, Paragraphs 31 and 32).

FBWT is your cash in the bank.

Let's consider how FBWT is reported on Note 3 to the financial statements.



## Fund Balance With Treasury (cont.)



### Note 3, Fund Balance With Treasury

Note 3. Fund Balance with Treasury		
As of March 31	2005	2004
<b>1. Fund Balances</b>		
A. Appropriated Funds	\$ 444,244,757,103.93	\$ 475,180,550,051.22
B. Revolving Funds	8,057,367,934.48	11,358,253,639.13
C. Trust Funds	(70,368,571.94)	835,775,264.63
D. Special Funds	173,091,590.39	0.00
E. Other Fund Types	12,181,949,389.35	7,023,255,878.26
F. Total Fund Balances	\$ 464,586,797,446.21	\$ 494,397,834,833.24
<b>2. Fund Balances Per Treasury Versus Agency</b>		
A. Fund Balance per Treasury	\$ 465,228,301,886.22	\$ 494,189,991,183.22
B. Fund Balance per	464,586,797,446.21	494,397,834,833.24
<b>3. Reconciling Amount</b>	\$ 641,504,440.01	\$ (207,843,650.02)

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Notice that the FBWT is made up of Appropriated, Revolving, Trust, Special, and Other fund types. Reporting includes the amounts reported per Treasury versus the amounts reported by the agency, with a resultant reconciling amount.

What processes and events decrease or increase your FBWT?

Let's look at the continuation of Note 3 for the detail of this reconciliation.



## Fund Balance With Treasury (cont.)



### Fund Balance With Treasury, Note 3 (cont.)

Reporting Entity (Amounts in millions)	Fund Balance with Treasury FY 2005	Fund Balance per Entity Books FY 2005	Reconciling Amount FY 2005	Reconciling Amount FY 2004
Navy GF	\$ 142,052	\$ 142,004	\$ 48	\$ 35
Air Force GF	116,361	116,344	17	
Army GF	120,976	120,987	(11)	
ODO GF	76,911	76,251	660	(243)
Corps of Engineers	5,110	5,183	(73)	
MERHCF	5	5		
MRF	20	20		
Air Force WCF	1,454	1,094	360	1,593
Army WCF	644	644		
ODO WCF	1,126	1,486	(360)	(1,593)
Navy WCF	569	569		
Total	<u>\$ 465,228</u>	<u>\$ 464,587</u>	<u>\$ 641</u>	<u>\$ (208)</u>

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In reporting differences between agency amounts and Treasury amounts, a breakdown is provided by reporting entity within the Department. Notice that the Total line compares to the totals in the previous section.

In accomplishing this reconciliation, and in evaluating your reporting on FBWT, several references are available to you.

In flow charting your processes, look at Appendix B in the Student Guide for an example.

Let's look at a list of a few of these references.



## Fund Balance With Treasury (cont.)



### References:

- **GAO/PCIE FAM, Volume 2, Section 921, Substantive Testing – Auditing Fund Balance With Treasury**
- **Treasury Financial Manual, Volume 1, Part 2, Chapter 5100, Reconciling Fund Balance With Treasury Accounts**
- **Treasury Financial Manual, Volume 1, Part 2, Chapter 5100 Supplement, Fund Balance With Treasury Reconciliation Procedures**
- **DoD FBWT Reference Tool, Monthly Reporting of Fund Balances to Treasury – DFAS Reporting Centers**

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These references may prove helpful in complying with the laws and regulations for FBWT:

- GAO/PCIE Financial Audit Manual Volume 2 Section 921, Substantive Testing – Auditing Fund Balance With Treasury
- Treasury Financial Manual, Volume 1, Part 2, Chapter 5100, Reconciling Fund Balance With Treasury Accounts
- Treasury Financial Manual, Volume 1, Part 2, Chapter 5100 Supplement, Fund Balance With Treasury Reconciliation Procedures
- DoD FBWT Reference Tool, Monthly Reporting of Fund Balances to Treasury – DFAS Reporting Centers. It includes an example of Audit steps the DoD OIG and audit entities will follow and incorporates GAO FAM audit steps. It was used by DFAS Internal Review when it reviewed FBWT for selected Defense Agency's management assertion readiness for FBWT.

Let's explore a few questions from the FAM to see what you can do in a review of your FBWT reporting.





## Fund Balance With Treasury (cont.)



### Fund Balance With Treasury Reporting

Assets	Yes, No or N/A	Explanation
<b>Fund Balance with Treasury (7 – 22)</b>		
10. Does the entity's fund balance with Treasury also include the following?  a. clearing account balances  b. balances for direct loan and loan guarantee activities held in the credit reform program, financing, and liquidating accounts  c. funds actually borrowed from Treasury under statutory authority  d. the dollar equivalent of foreign currency account balances (SFFAS 1, par. 32 & 35)		

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In assessing the effectiveness of your internal controls, check the FAM for definitive information about your reportable lines. If you can answer these with a yes or does not apply, you can be assured of your entity's auditable success.

This question relates to the FBWT as reported in the Assets section of the Balance Sheet. It asks whether the entity's FBWT also includes: (a) clearing account balances, (b) balances for direct loan and loan guarantee activities, (c) funds actually borrowed from Treasury under statutory authority, and (d) the dollar equivalent of foreign currency account balances.

This should remind you of the format that is in place for Note 3, FBWT reporting.

Let's look at two more questions.



## Fund Balance With Treasury (cont.)



### Fund Balance With Treasury Reporting (cont.)

268. Is the sum of the fund balances with Treasury, cash, and foreign currency at the beginning of the fiscal year reported below the net amount from the previous question? (OMB Bull. 94-01, app. C, p. 36, item 39)		
269. Does the sum of the fund balances with Treasury, cash, and foreign currency at the beginning of the fiscal year (as determined in the previous question) agree with the sum of the balances reported for those accounts on the prior year's Statement of Financial Position? (OMB Bull. 94-01, app. C, p. 36, item 39)		

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Again we address the FAM auditing questions. These questions are related to the Statement of Financial Position. Question 268 asks whether the sum of the Fund Balances With Treasury, cash, and foreign currency at the beginning of the fiscal year reported below the net amount. Question 269 is concerned with agreement of beginning amounts with amounts reported on prior years totals.

Questions of this nature check for the continuity of your recording and reporting, and whether you have adequately explained any adjustments that have been made.

Notice that there is continuity and connectivity to the questions.

Now let's summarize what we learned in this lesson.



## Lesson Summary

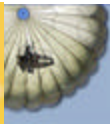


- **Evaluating Lines for Materiality**
- **Process Flows to Document Business Processes (with some examples using):**
  - **Military Equipment**
  - **Real Property**
  - **Environmental Liabilities**
  - **Fund Balance With Treasury (FBWT)**

In this lesson, we discovered how to identify and evaluate materiality with specific reference to some of the current line items recognized in the Department's financial statements, to include Real Property, Military Equipment, Environmental Liabilities, and FBWT.

In this lesson, you also learned that a common procedure used to document business processes is the preparation of a cycle memo. A cycle memo is a narrative representation of the sequence and content of your business process. You also learned that a deficiency may be deemed to be material if it significantly impairs fulfillment of mission; significantly weakens safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; violates a statutory requirement; allows fraud to go undetected; deprives the public or the Component of needed services; or causes significant adverse publicity for your entity.

The following slide lists references available for additional information.



## References



**GAO/PCIE FAM:** <http://www.gao.gov/special.pubs/gaopcie/>

**GAO Standards for Internal Control in the Federal Government:** <http://www.gao.gov/special.pubs/ai00021p.pdf>

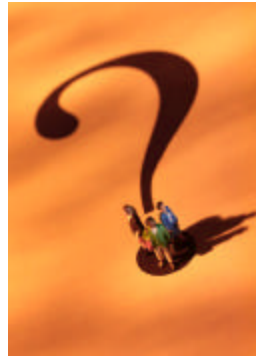
**FAM Checklists:** [http://www.gao.gov/policy/famv2\\_.pdf](http://www.gao.gov/policy/famv2_.pdf)

**FFMIA:** <http://www.gao.gov/new.items/d05225g.pdf>

**PAR:** [http://www.defenselink.mil/comptroller/par/fy2004/01-01\\_MD\\_and\\_A.pdf](http://www.defenselink.mil/comptroller/par/fy2004/01-01_MD_and_A.pdf)

**Internal Control, Comptroller's Handbook:**  
<http://www.occ.treas.gov/handbook/intcntrl2.pdf>

**OMB Circulars:** <http://www.whitehouse.gov/omb/circulars/>



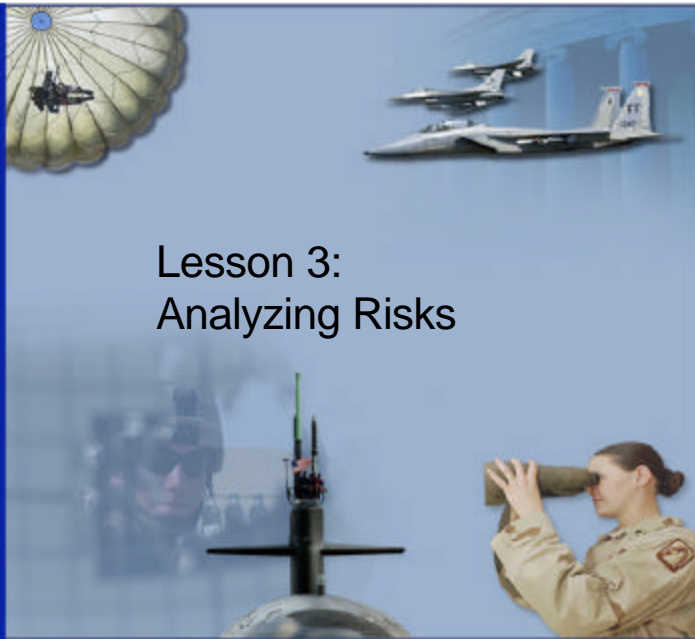
Before we move on to Lesson 3, Analyzing Risks, do you have any questions on the material covered in this lesson?

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Effective  
Internal  
Control  
for Financial  
Reporting



Lesson 3:  
Analyzing Risks



In this lesson, we are going to discuss risk analysis and management assertions that substantiate that your internal control addresses the risks realized in everyday operations.

We will also examine risk and how it defines which internal control best fits your organization's operations and financial reporting.

This subject is important because you are the people that can mitigate the identified risks.

Let's discuss the lesson objectives.



## Lesson Objectives



**Upon successful completion of this lesson, you will be able to:**

- **Discuss materiality and its relationship to risk**
- **Discuss risk analysis**
- **Discuss management assertions**
- **Explain tests of internal control**

This lesson will discuss materiality and its relationship to risk with the view that each Component, agency, and unit has differing perspectives on what is or isn't material to its operations. Materiality will dictate what is to be asserted. Are your reports based on fact or supposition? Is your internal control program efficient and effective enough to substantiate your assertions?

This lesson will also provide you with an understanding of risk analysis as part of risk management. Risk analysis is important to you, as a proper identification and analysis of risk will provide your organization with the basis to design and implement an internal control program to mitigate those risks identified.

We will relate experiential results of risk analysis with Real Property, Military Equipment, Fund Balance with Treasury (FBWT), and Environment Liabilities which will assist you in getting off on the right foot with your analysis.

We also discuss the assertions tested by auditors to give you a perspective on the assertion process. Finally, we look at the testing of internal control which provides the auditor the basis for assessing whether or not an internal control is in place, assuring that the organization is, in fact, ready for an audit.

Let's look at the topics supporting these objectives.





## Lesson Topics



**This lesson contains the following topics:**

- **Risk as Associated with Materiality**
- **Analysis of Risk**
- **Existence or Occurrence**
- **Completeness**
- **Rights and Obligations**
- **Valuation or Allocation**
- **Presentation and Disclosure**

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This lesson will discuss how risk, as associated with materiality, has a definitive effect on where you will concentrate the majority of your resources to reduce that risk. This lesson will also discuss how to mitigate risk related to some of the lines that have had a material effect on your financial reports, Real Property, Military Equipment, Environmental Liability, and FBWT. Where might you look for risk in financial reporting? Risk in financial reporting is inherent when dealing with complex programs, operations, and transactions. The sheer magnitude of them can often be laden with risk. Often, obligation estimates are a necessity, however, there is a risk involved if the estimates are not realistic or eventually not replaced with actuals.

If faced with manual processes or applications there is always a risk of when human error is involved. With changes such as new operating environments, new or revamped information systems, new or changed programs, and new technology, significant risk is prevalent. Changes in personnel or the addition of new personnel can cause difficulties and risk if not properly trained. Whenever new or amended laws, regulations, and standards occur there will be risk in how it will affect the operations. Moving from a decentralized to centralized accounting and reporting function or vice versa, may also have a certain amount of risk involved.

The five management assertions (Existence or Occurrence, Completeness, Rights and Obligations, Valuation or Allocation, and Presentation and Disclosure) provide you the framework for the evidential matter that you provide the auditor to support your financial statements and the fundamental basis for the Statement of Assurance (SOA). The SOA Over Internal Control is the assertion by management that the internal control system in place is working properly. It asserts that the management assertions are of sound foundation for the rigorous audit questions due to tight internal control.

Let's look at the first topic, Risk as Associated with Materiality, beginning with a definition.



## Risk as Associated with Materiality



**“Risk is the probable or potential adverse effects from inadequate internal control that may result in the loss of government resources or cause an agency to fail to accomplish significant mission objectives through fraud, error, or mismanagement.”**

Risk is the probable or potential adverse effects from inadequate internal control that may result in the loss of government resources or cause an agency to fail to accomplish significant mission objectives through fraud, error, or mismanagement.

Basic risk management strategy will identify critical areas and risk events, both technical and non-technical, and take necessary action, developing internal control, to handle them before they can become problems, causing serious cost, schedule, or performance impacts.

Risk events should be defined to a level such that the risk and causes are understandable and can be accurately assessed in terms of likelihood/probability and consequence to establish the level of risk. For processes, risk events are assessed in terms high, moderate, or low, and are associated with the five management assertions.

Now let's see how risk relates to materiality.



## Risk as Associated with Materiality (cont.)



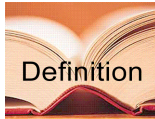
- **Materiality of risk and the management perspective**
- **Examples of material weaknesses**
- **Risk from an auditor's viewpoint**
- **Minimizing risk**

Risk can cause material misstatements. If information is corrupted because of inadequate internal control, that information might serve as a basis for decisions that affect national Defense and/or the expenditure of resources in a tight economy. It can cause a ripple effect on associated programs in need of those limited resources and roll up hill to the granter of those funds, making next year's funding only a dream sheet.

Management looks at risk through a cause and effect relationship. Materiality is based on the concept that items of little importance which do not affect the judgment or conduct of a reasonable user do not require auditor investigation. Materiality has both quantitative and qualitative aspects.

For example, intentional misstatements or omissions (irregularities) usually are more critical to the financial statements users than are unintentional errors of equal amounts. This is because the users generally consider an intentional misstatement more serious than clerical errors of the same amount. An act of commission is a conscious effort to abridge a law.

Let's discuss reasonable assurance from the management perspective.



## Risk as Associated with Materiality (cont.)



### Management Perspective

**Reasonable Assurance – An informed judgment by management as to the overall adequacy and effectiveness of internal control based on available information that the internal control system is operating as intended.**

Reasonable assurance is management's judgment based upon available information that the system of internal control operates as intended, adequately controls the identified risks, and provides reasonable assurance (a satisfactory level of assurance, not absolute) to management that risks related to fraud, waste, and abuse are controlled.

The standard of reasonable assurance equates to a satisfactory level of confidence under given considerations, costs, benefits, and risks. You must identify risk and determine acceptable levels of risk under varying circumstances.

Let's discuss some different methods for risk mitigation.



## Risk as Associated with Materiality (cont.)



### Mitigate risk factors by:

- **Strategic focus**
- **Communications**
- **Risk identification and integration**
- **Assessment**
- **Addressing Murphy's Law**

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In order to mitigate or lessen the impact of risk on your organization's operations, you must have an effective internal control program that includes the following factors:

A strategic focus that is pervasive throughout the organization is supported from the top down. This means that if all decisions, orders, projects, and programs support the strategic goals of the entity, then you have already mitigated an all encompassing risk.

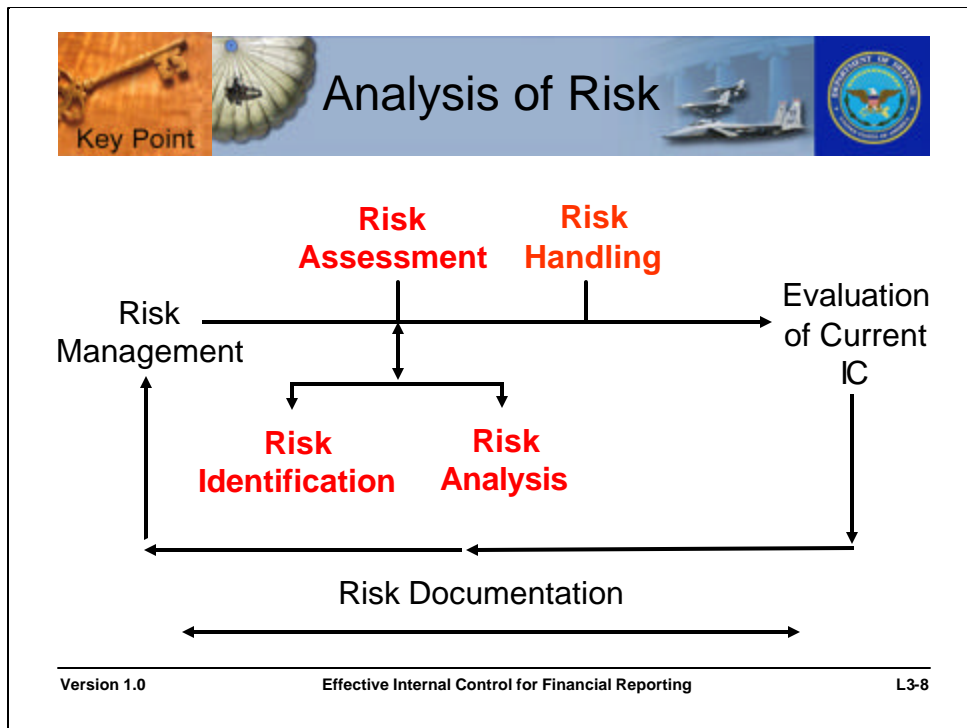
An information program that communicates the potential risks at each level of an organization will ensure that the risks are diminished proactively with established internal control activities.

Risk identification is necessary at the inception of a plan, project, or program so its existence can be integrated into each stage of implementation and not overlooked.

Risk assessment of the damage potential and probability of occurrence is necessary in order to have resources in place to combat risk.

Murphy's Law, which states that if anything can go wrong, it will, means that all organizations need a plan in place for every conceivable risk, no matter how remote.

We have the focus, information, integration, and assessment. Now let's turn our attention to how we address the recognized risk.



Risk assessment is the process of applying risk identification and risk analysis to program areas and critical technical process risks to increase the probability/likelihood of meeting costs, schedule, and performance objectives.

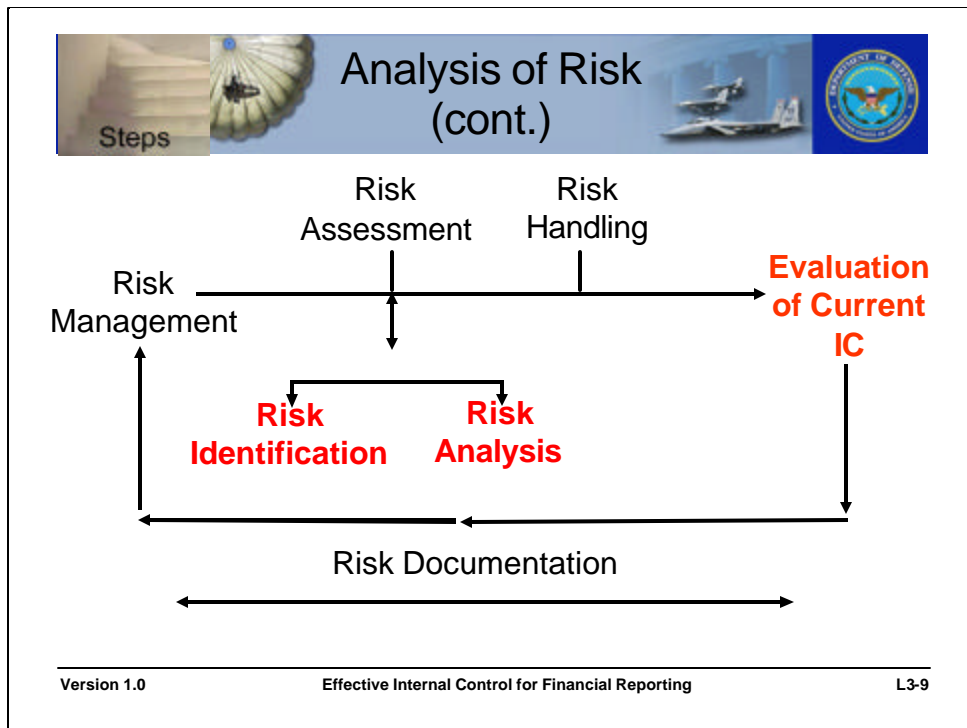
Risk identification is the process of examining the program areas and each critical technical process to identify and document associated risk.

Risk analysis is the process of examining each identified risk area or process to refine the description of the risk, isolate the cause, and determine the effects. It includes risk rating and prioritization in which risk events are defined in terms of their probability of occurrence, severity of consequence or impact, and relationship to other areas or processes.

Risk handling is the process that identifies, evaluates, selects, and implements options in order to set risk at acceptable levels given program constraints and objectives. This includes the specifics on what should be done, when it should be accomplished, who is responsible, and the associated cost and schedule.

The most appropriate strategy is selected from these handling options and becomes an internal control. Risk handling is an all encompassing term whereas risk mitigation is one subset of risk handling.

Let's continue with what is needed to evaluate the mitigators that you have selected.

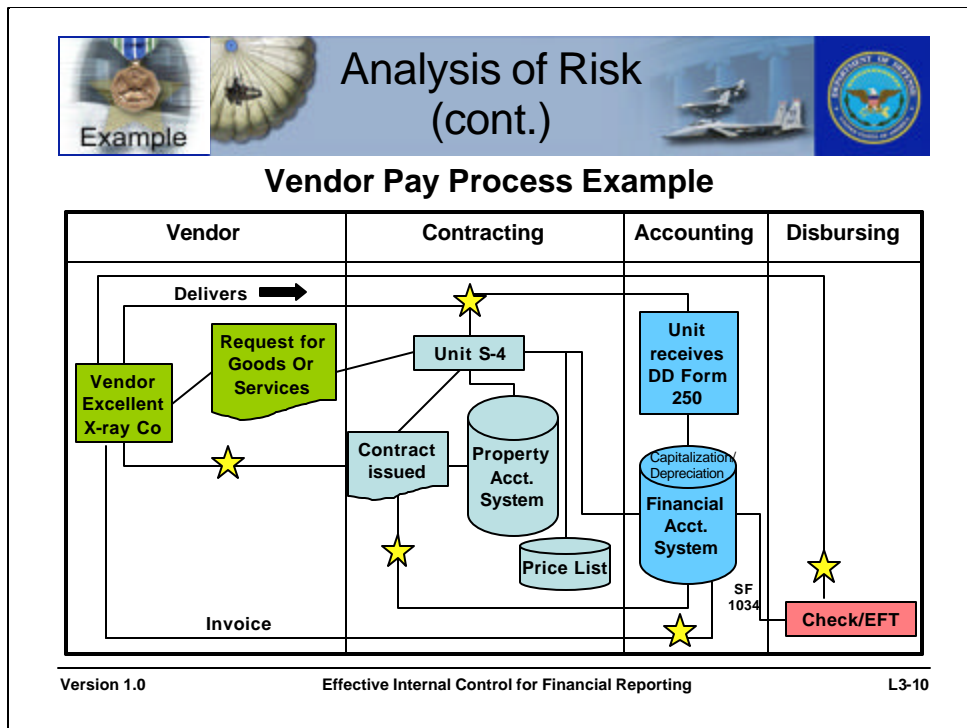


Evaluating current internal control is the process that systematically tracks and evaluates the performance of internal control against established metrics and develops further internal control, as appropriate. The improved internal control feeds back into the other risk management activities of assessment and handling.

Internal control is created to mitigate risk. Standard Operating Procedures (SOPs) are translations of internal control and are your means for implementing and monitoring the internal control process.

Use DoD Risk Assessment forms to report risk analyses to support your statement of assurance on internal control over financial reporting.

Let's take a look at a business process and how risk analysis will assist you in assessing the risk.

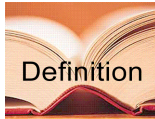


Looking at a simplified vendor pay process, can you apply a generalized risk analysis? Do you see where accounting estimates may be used? Will the rules for depreciation be followed? Is any of the documentation manual? With changes to fuel prices no longer being a monthly fluctuation, would that affect the operating environment? When will the receipt be recorded? Every business process has the possibility of something going amiss during each step. You must be ready to adjust and react to a constantly evolving business environment.

As we mentioned earlier, flow charts play a key part in analyzing your processes. Risk analysis is also a process that requires a flow chart. Albeit not an integral part to performance or production, it is necessary to target the risk that can be found at every twist and turn of the processes that lead to mission completion.

Now that we understand where risk analysis stands in the structure of risk management, let's look at how risk management relates to the internal control or SOPs for Real Property, Military Equipment, Environmental Liabilities, and FBWT to mitigate risk.





## Analysis of Risk (cont.)



### Real Property

**Real Property internal control encompasses the custody, safekeeping, and effective use of land, buildings, structures, and facilities. It includes:**

- **Real Property accountability records**
- **Real Property information**
- **Excess and surplus property**
- **Transferred property**
- **Physical inventories**

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Internal control for Real Property requires you to account for and be responsible for the custody, safekeeping, and effective use of land, buildings, structures, and facilities. You must document and maintain Real Property accountability records. Those records must be complete, accurate, and allow for timely recording/reporting of Real Property information. Records must be maintained that establish custody and accountability for excess and surplus property.

All property transferred in and out of the installation must be accounted for. Physical accountable inventories of all Real Property are conducted at least once every five years. That inventory information is kept on file and the results of the physical inventories status are reported as of September 30.

Let's look at an example that the U.S. Army Corp of Engineers (USACE) encountered with respect to a weakness in Real Property internal control and its impact on risk analysis.



## Analysis of Risk (cont.)



### Real Property

**The United States Army Corp of Engineers (USACE) Real Property internal control example of a misstatement on the Balance Sheet was resolved when all parties agreed to use database information in the absence of source documentation to provide accurate recording on the Balance Sheet.**



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The USACE carries on its Balance Sheet several types of buildings and structures to perform its mission which include dams, bridges, reservoirs, and locks. The major asset classes are buildings and other structures, land, Construction-in-Progress (CIP), and equipment. The Department of Defense Financial Management Regulation (DoDFMR) 7000.14-R requires that evidential matter that documents the acquisition cost, acquisition date, and cost of improvements of assets must be maintained at a readily available location during the retention period.

Due to conflicting guidance with respect to the retention of evidential matter and lack of internal control, the USACE lacked the documentation to substantiate the book cost of a significant portion of its Real Property assets. With respect to risk analysis, the critical technical process is the impact that this misstatement would have on the Balance Sheet. The problem was resolved when all parties agreed to use database information in the absence of source documentation to provide the dollar value assigned to an asset. Statement of Federal Financial Accounting Standards (SFFAS) No. 6 and the DoDFMR allow for the use of alternate methods to estimate and support the acquisition cost for Real Property assets with remaining useful lives for transactions occurring before October 1, 1998. Conversion spreadsheets provided through Corps of Engineers Management Information Systems (COEMIS) and Corps of Engineers Financial Management System (CEFMS) and attestation agreements from real estate and resource management personnel that cost assigned to individual items were based on actual real estate records.

Now let's look at other related real property risk.



## Analysis of Risk (cont.)



### Real Property (cont.)

#### Property, Plant, and Equipment (PP&E) cost challenges:

- Insufficient supporting documentation
- Property and logistics systems not integrated into financial systems



To minimize the risk of continued erroneous reporting, you should ascertain the need to develop documentation for the cost and depreciation of these items. Other areas of concern include insufficient supporting documentation, particularly for Property, Plant, and Equipment (PP&E) that was purchased many years ago.

We should also include legacy property and logistics systems that are not integrated with acquisition and financial systems, thus preventing capture of the acquisition cost, modification cost and upgrades, or the calculation of depreciation.

Let's look at how accurate and well documented inventories assist in mitigating risks.



## Analysis of Risk (cont.)



### Real Property (cont.)

**Physical inventory of property should assure:**

- **Periodic, independent verification of the accuracy of both the accountability records and accounting records**
- **Reconciliation of subsidiary property accountability records to the general ledger accounts**
- **Source documentation is adequate to support the inventory**

Inventories of property should assure the entity of the existence and completeness of PP&E.

The DoDFMR describes this as a book to floor and floor to book process. The accountability records and the accounting records must be based on the same information. This requires a reconciliation process between the property accountability systems (one example is the Defense Property Accountability System (DPAS)) , accounting systems, and source documentation.

Therefore with an established audit trail, risk is mitigated.

Now let's examine risk analysis from the newly assimilated category of PP&E, Military Equipment.



## Analysis of Risk (cont.)



### Military Equipment

**Military Equipment Internal Control Guidance can be found in SFFAS No. 23.**



Military Equipment includes aircraft, ships, weapons, intelligence systems, combat vehicles and command and control systems. In May 2003 the Federal Accounting Standards Advisory Board (FASAB) provided controls by adopting the SFFAS No. 23 which classified Military Equipment as personal property assets and is reported on the Balance Sheet as General PP&E. SFFAS No. 23 requires that Military Equipment be capitalized which includes the recapitalization of modification and upgrades.

Establishing a value on Military Equipment in service which has not been valued for financial reporting purposes may be difficult. Historical budgeted data from the Bureau of Economic Analysis is used to estimate the original value. Once a value is established, Military Equipment is capitalized into the accounting statements and depreciated.

Let's carry on with a risk in Military Equipment reporting that has garnered a strategic focus.



## Analysis of Risk (cont.)



### Military Equipment (cont.)

**Military Equipment example of proper recording on the Balance Sheet.**



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Military Equipment provides a good example of risk analysis as a strategic focus applied through the SFFAS No. 23 to provide top down acceptance and implementation of this standard of valuation.

Each branch of the Military Services and its Components communicates these values on their financial statements as General PP&E and depreciates these values based on historical budget data or cost data, raising the visibility of potential risk.

Now that we've covered Military Equipment, let's consider Environmental Liabilities.



## Analysis of Risk (cont.)



### **Environmental liabilities controls provide for:**

- **Documentation of audit trails**
- **Supervisory review of estimates**
- **Development of estimates**
- **Qualification of estimators**
- **Completeness of estimates**
- **Quality assurance reviews**

Internal controls associated with environmental liabilities provide for the documentation of audit trails, supervisory review of estimates, and development of estimates. It also provides for the qualification of estimators, completeness of estimates, and quality assurance reviews.

Next, let's study some of the details for the Environmental Liabilities internal control program.



## Analysis of Risk (cont.)



### Environmental Liabilities

Information that supports an audit trail for environmental liability:

- Estimator's name
- Date of estimate
- Conditions surrounding project
- Clean-up methodology
- Assumptions
- Physical aspects
- Quantities
- Cost elements
- Supervisory reviews
- Project changes



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Audit trails allow the capability to trace or replicate a transaction from its source to the resulting record or report and the resulting record or report to the source. The DoDFMR requires that adequate documentation be maintained for an effective audit trail. Cost estimates create audit trails to report environmental liabilities and become accounting estimates. The cost estimate includes summary documents that support the operations and maintenance costs. Background information included in the cost estimates are the estimator's name, completion, date of the estimate, information on conditions surrounding the project, methodology and/or steps for clean-up. Also included are assumptions that provide a reasonable estimate of the needed items for project cleanup that are anticipated but actual amounts are unknown at the time the estimate is being completed. Physical aspects are also included to show the tangible assets of the project, such as acres of land and number of monitoring wells associated with the project. Additional requirements should include quantities needed for a particular physical aspect, its associated cost, individual costs associated with a cost estimate, and the recognition of the addition or removal of cost when the project is funded. There must be a supervisory review which includes a documented signature and date of the supervisor approving the estimate and a written approval of any justification for an increase or decrease in project costs due to a project change.

Risk assessment of environmental liabilities is accomplished by examining the key cost estimate components. As a result of risk assessment, risk identification determined that documentation and audit trails, supervisory reviews, quality control, and quality assurance reviews were critical elements. Risk analysis must now be performed on these critical elements to isolate the causes of risk, determine the effect that risk will have on reporting, and design a control that will mitigate the risk's effect.

Now that we've covered risk analysis with environmental liabilities, let's continue with how risk analysis relates to FBWT.





## Analysis of Risk (cont.)



### Fund Balance With Treasury

**Key FBWT risk identified by DFAS management:**

- **Unsupported undistributed transactions**
- **Lack of an audit trail**
- **Lack of process flow charts**
- **Inability to follow transactions back to point of origin**
- **Late payments**
- **Lack of continuity in the reconciliation process**
- **Inconsistent materiality basis**
- **Aged transactions**
- **Suspense accounts**

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DFAS, through their risk analysis process, has identified the risk associated with FBWT and has come up with a plan to mitigate this risk with the objective of an auditable statement.

Management has identified key focus areas to address FBWT issues. Those key focus areas are to eliminate unsupported undistributed transactions, ensure good audit trails, and document the FBWT process. A complete track of transactions back to the source is required, and disbursements must post in 15 days.

Management is to establish a sustainable, repeatable, and auditable reconciliation process; establish materiality criteria; cleanup suspense accounts; and aggressively research inflow and aged transactions for elimination.

Let's consider some of control activities that minimize risk in PP&E transactions.



## Analysis of Risk (cont.)



### **Minimize risk by:**

- **Re-evaluating policies and procedures to provide consistent guidance**
- **Performing a physical inventory and update of property accountability records**
- **Performing reconciliations between financial and functional records (Property Book, inventory sheets, PBAS, etc.)**
- **Ensuring controls over the accuracy and completeness of acquisition costs, date, description, and location**
- **Ensuring source documents are valid, accurate, and reliable**

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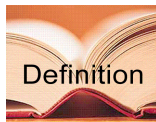
L3-20

Often inconsistencies lie with policies and procedures that cause confusion and are therefore treated differently from reader to reader. Policy must be reviewed periodically to ensure that it continues to be relevant and doesn't evoke various interpretations. Tasks as seemingly simple as ensuring that inventory records match actual counts may fall victim to inconsistent application. With periodic reconciliations, you can solve this problem.

Some agencies have established poor internal control and management oversight, allowing inconsistent application or interpretation of guidance. While, for example, the task of ensuring full data collection on new and existing Property Plant & Equipment (PP&E) is given full attention, it's also important to ensure that current practices are in line with all policies and procedures. It's everyone's responsibility to ensure that source documents (or inputs) are valid, accurate, and reliable.

The bottom line is to ensure the rights established by source documents, like costs, dates, appropriation, and so forth, are accurately documented and input into accountability and accounting systems.

We'll continue by discussing each of the management assertions. But first, what are management assertions?



## Analysis of Risk (cont.)



### What are management assertions?

- **Representations by management that are embodied in financial statements components**
- **Representations that are either explicit or implicit**
- **Representations are classified into five categories**

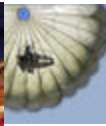
In general terms, assertions are statements to the auditors that your operations are effectively and efficiently using your allotted resources and that financial reporting on these operations is being fairly represented on the financial statements.

Management assertions are representations by management. Management assertions can be either explicit or implicit and are classified into five categories.

These definitions will be explained in some detail later in the lesson.

An auditor's work in forming an opinion on financial statements consists of determining whether balances and notes presented in the Department's financial statements fairly represent the operations of the entity at the lowest levels. After obtaining evidential matter in support of financial statements assertions, the auditor develops audit objectives and designs substantive tests for those assertions. These substantive tests are methods used to verify and validate the information.

The following slide gives you a look at which evidential matter relates to which management assertion.



## Analysis of Risk (cont.)



### The Five Categories of Assertions

Business Processes	Existence or Occurrence	Completeness	Valuation or Allocation	Rights & Obligations	Presentation & Disclosure
<b>Real Property Inventory</b>					
Direct Inspection & Observation	X	X	X	X	
<b>Environmental Liabilities Cost Estimates</b>					
Inquiries, Interviews, & Questionnaires	X	X	X	X	X
<b>Military Equipment SFFAS No. 23 Adjustments</b>					
Relevant Laws & Agency Regulations	X		X	X	X
Documents of Public Record	X		X	X	X
Contracts, Agreements, Deeds, & Leases	X	X	X	X	
Certified Appraisals	X		X		X
Transfer & Shipping Reports	X	X	X	X	
Inventory Reports	X	X	X	X	X
Purchase Orders, Receiving Reports, Invoices	X	X	X	X	
System Reports & Client Prepared Schedules		X	X	X	
Maintenance Records	X	X	X		
<b>Fund Balance With Treasury</b>					
Payment Vouchers, Checks or EFT #	X	X	X	X	
Comparisons, Ratios, Expected Relationships	X	X	X		

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This slide provides examples as to what category of assertions can be met by various types of evidence. The left column lists types of evidence (physical, testimonial, documentary, and analytical). The five columns to the right represent the five categories of assertions. This format provides the user a means of documenting evidential matter as it relates to the five categories of assertions.

Now let's look at each of the five broad categories of assertions.



## Existence or Occurrence



### Existence or Occurrence Category, Example A

Assertion	Risk	Necessary Control	Test of Control
Existence or Occurrence	A cash disbursement may be made for an unauthorized purpose (existence or occurrence of valid transaction)	Approved payment voucher with matching supporting documents (invoice, receiving report, and approved purchase order) for each disbursement. Only authorized personnel allowed to issue checks. Segregation of duties for approving payment and check issuance.	Sample of cash disbursement transactions, determine existence of approved payment voucher and matching supporting documents for each disbursement. Observe individual issuing checks and/or compare signatures on authorization documents with list of authorizers. Observe segregation of duties.

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When auditors are presented these assertions, they develop their audit objectives.

An assertion made by management about existence or occurrence addresses whether assets or liabilities exist at a given date and whether recorded transactions have occurred during a given period.

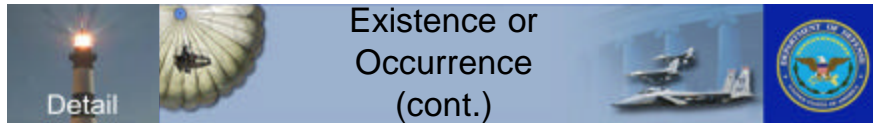
In the existence or occurrence category, management asserts that all of the inventory included in the Balance Sheet physically exists. The auditors develop substantive tests to verify this assertion made by management. Test this assertion through observing physical inventory counts, obtaining confirmation of inventories at locations outside of the entity, or testing inventory transactions between a preliminary physical inventory date and the Balance Sheet date.

Here's an example found in the Government Accountability Office/President's Council on Integrity and Efficiency Financial Audit Manual (GAO/PCIE FAM). Example of potential risk: A cash disbursement may be made for an unauthorized purpose.

Internal control: Necessary control includes an approved payment voucher with matching supporting documents (invoice, receiving report, and approved purchase order) for each disbursement. Only authorized personnel are allowed to issue checks. Segregation of duties for approving payment and issuance of checks is necessary. This is why Accounts Payable offices are separated from Disbursing Offices.

Test of control: A sample of cash disbursements transactions is taken to determine the existence of an approved payment voucher and matching supporting documents for each disbursement. Observe individual issuing checks and/or comparing signatures on authorization documents. You may also obtain cancelled checks with list of authorizers. Observe segregation of duties being performed.

Let's look at another example of the category Existence or Occurrence.



## Existence or Occurrence Category, Example B

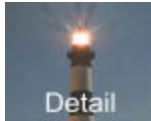
Assertion	Risk	Necessary Control	Test of Control
Existence or Occurrence	A voucher may be paid twice	Stamp payment voucher and supporting documents "PAID" when check is issued	Observe documents being stamped and/or inspect sample of paid documents for presence of "PAID" stamp

Example of potential risk: A voucher may be paid twice, which is an example of the assertion of existence or occurrence.

Internal control: Stamp payment voucher and supporting documents "PAID" when check is issued.

Test of control: Observe documents being stamped and/or inspect sample of paid documents for presence of the PAID stamp.

Let's look at examples of Existence or Occurrence in Environmental Liabilities.



Detail



Existence or  
Occurrence  
(cont.)



**Background information categories that support an audit trail for environmental liability and management assertions:**

- **Estimator's name**
- **Date of estimate**
- **Estimation method**

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These categories of background information on environmental liabilities support the existence or occurrence assertion:

- estimator's name
- date the estimate was complete
- estimation method.

Let's turn our attention to the next management assertion, Completeness.



## Completeness



### Completeness Category Example

Assertion	Risk	Necessary Control	Test of Control
Completeness	A cash disbursement transaction may not be recorded (completeness) or it may be recorded for the wrong amount (valuation or allocation)	All disbursement transactions are made by check. All checks are pre-numbered and accounted for. Unused checks are stored in a secure area. Independent check of agreement of daily summary of checks issued with entry to cash disbursements are performed. Periodic independent bank reconciliations are completed.	Inquire about methods of making cash disbursements and/or inspect paid checks for sample of disbursement transactions. Examine evidence of use of and accounting for pre-numbered checks and/or scan sequence of check numbers in check register or cash disbursements journal. Observe handling and storage of unused checks. Observe performance of independent check and/or re-perform independent check. Observe performance of bank reconciliation and/or inspect bank reconciliations

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An assertion made by management about completeness addresses whether all transactions and accounts that should be presented in the financial statements are included.

For example, you may assert that all purchases of goods and services, within a specific period, are included in your financial reports. Based on this assertion, you would conduct substantive tests to determine if all of the goods and services are included in the financial reports.

This is an example of completeness found in the GAO/PCIE FAM.

Example of potential risk: A cash disbursement transaction may not be recorded (completeness) or it may be recorded for the wrong amount (valuation or allocation).

Internal control: All disbursement transactions are made by check. All checks are pre-numbered and accounted for. Unused checks are stored in a secure area. Make an independent check of agreement of daily summary of checks issued with entry to cash disbursements. Perform periodic independent bank reconciliations.

Test of control: Inquire about methods of making cash disbursements and/or inspect paid checks for samples of disbursement transactions. Examine evidence of use of, and accounting for, pre-numbered checks and/or scan sequence of check numbers in a check register or cash disbursements journal. Observe handling and storage of unused checks. Observe performance of independent check and/or re-perform independent check. Observe performance of bank reconciliation and/or inspect bank reconciliations.

Let's consider our next management assertion, Rights and Obligations.





## Rights and Obligation Example

Assertion	Risk	Necessary Control	Test of Control
Rights and Obligations	An entity does not record property for which it is the preponderant user	Re-evaluate policies and procedures to provide consistent guidance. Perform a physical inventory and update property accountability records.	Inquire about personnel knowledge of the rules on preponderant use. View Memorandums of Agreement (MOAs) and Memorandums of Understanding (MOUs) on use of facilities. Check for agreement with property and financial records.

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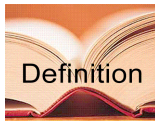
An assertion made by management about rights and obligations addresses whether assets are the rights of the Department and the liabilities are the obligations of the Department at a given date.

For example, the Department asserts that amounts capitalized for PP&E in the Balance Sheet represent the cost of the entity's rights to the PP&E and that the corresponding leased property liability represents the obligation of the entity.

As seen in the above chart, often inconsistencies lie with policies and procedures that cause confusion and are therefore treated differently from reader to reader. Policy must be reviewed periodically to ensure that it continues to be relevant and doesn't evoke various interpretations.

The bottom line is to ensure the rights established by source documents, like costs, dates, appropriation, and so forth, are accurately documented and input into accountability and accounting systems.

Preponderant use in PP&E is a prime example of rights and obligations. It would also impact recognition of assets and liabilities in Military Equipment and Environmental Liabilities. Let's look at preponderant use in detail.



## Rights and Obligations (cont.)



### What is preponderant use?

**This concept states that the preponderant user of a facility generally must recognize and report the facility used in their operations.**

**An example might include a commissary on an Air Force base. The Air Force reports the accountability of the property while the Defense Commissary Agency (DeCA) reports the financial accountability.**

**The DoDFMR, Volume 4, Chapter 6, provides guidance for reporting of preponderant use.**

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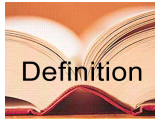
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It is important to understand this concept of preponderant use. This concept states that the preponderant user of a facility must recognize and report the facility used in its operations in its financial statements. Assets are recognized properly and are reported only once on financial statements. Therefore, the Defense Agencies should coordinate with Military Departments to ensure completeness in reporting assets and avoid duplicate reporting of them on financial statements. The Defense Agencies that produce financial statements and/or are included in the Department's consolidated financial statements generally must recognize and report the facilities used in their operations. In all instances, the facilities used by the Defense Agencies are owned by, or titled to, the Military Departments.

There are two methods that could be used to document which entity recognizes the assets for accounting and reporting purposes, the Interservice Support Agreement (ISA) and Memorandums of Agreement (MOAs)/Memorandums of Understanding (MOUs). The DoDFMR, Volume 4, Chapter 6, PP&E, provides the guidance for recognition of acquired assets for accounting and reporting purposes. In all instances, the asset is recognized by the component that acquires the asset. There is an exception based on the concept of preponderant use.

The ISA identifies the supplying activity and the receiving activity. It may specify what support the Defense Agency receives including billing, reimbursements, and specific provisions such as reporting on their financial statements. MOAs and MOUs establish command-to-command relationships, statements of fact, intentions, procedures, and matters of coordination agreed on by the signatories. MOAs and MOUs are not substitutes for formal interservice, intraservice, interdepartmental, or interagency support agreements.

Let's discuss how to recognize the preponderant user.



## Rights and Obligations (cont.)



### **Rules used to identify who recognizes the asset for accounting and reporting purposes:**

- **The asset must embody a probable future benefit that will contribute to the activity's operations**
- **The activity that reports the asset must be able to obtain the benefit and control access to the benefit inherent to the asset**
- **Transaction or event already occurred**
- **Only report cost of assets material to preponderant user**

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The basic question is, who recognizes an asset for accounting and reporting purposes? In most instances, legal ownership is usually, but not always, the determining factor that Components use to recognize an asset. For example, buildings used by a Working Capital Fund (WCF) may not have been constructed with WCFs. However, the buildings should be capitalized and depreciated by the WCF and reported by them on their financial statements.

Four criteria are used when determining what Component must recognize the PP&E. The asset must embody a probable future benefit that will contribute to the Component's operations. The Component that reports the asset must be able to obtain the benefit and control access to the benefit inherent to the asset. The transaction or event giving a Component the right to, and control over, the benefit of an asset must have already occurred. Lastly, the Component should only report predominately used assets owned by other Components when the cost of those assets, taken as a whole, are material to the predominate user's financial statements.

Let's look at some examples of preponderant use.



## Rights and Obligations (cont.)



### Examples of preponderant use:

- **Military Departments - General Fund**
- **Defense Agencies - General Fund**
- **Working Capital Funds**



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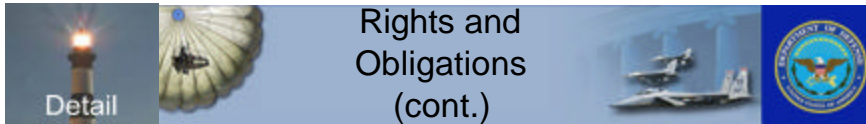
These are three examples of preponderant use.

An example of preponderant use for Military Departments – General Fund, is the Air Force as a tenant in a building on an Army installation. The Army should report the asset on its financial statements, not the Air Force. This policy recognizes that the Military Departments routinely use each other's facilities in the normal course of carrying out their missions.

An example of preponderant use for Defense Agencies – General Fund, are Defense Agencies that produce financial statements that are included in the DoD consolidated financial statements, must recognize and report the facilities used in their operations. These facilities used by the Defense Agencies are owned by the Military Departments. These facilities are material to the Defense Agencies' financial statements and should be reported on the annual financial statements of the Defense Agencies' and excluded from the financial statements of the Military Departments. Coordination between the Defense Agencies and the Military Departments must be done to ensure completeness and avoid duplicate reporting of assets.

An example of preponderant use for WCFs is when a WCF activity is the preponderant user of a facility, the activity should report and depreciate the facility on its financial statements. The basic idea of preponderant use is to recognize the assets and determine on which activity's financial statement they are reported.

Let's look at the rule for preponderant use and capital improvements.



**Preponderant use and capital improvements rules:**

- **If a Working Capital Fund (WCF) funds capital improvements, this activity should report and depreciate the improvements on its financial statements**
- **If a Defense Agency (WCF) occupying its facility with a Military Department makes capital improvements, the Defense Agency reports the depreciation and improvements on its financial statements**
- **Supporting documentation must be available to support the financial statements reporting improvements**
- **Maintenance or repair work is not considered a capital improvement, even if the cost equals or exceeds the capitalization threshold, this work is expensed**

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If a WCF funds capital improvements, it reports and depreciates the improvements on its annual financial statements, whether or not the activity is the preponderant user of the facility improved.

If a Defense Agency WCF occupies a facility with a Military Department and makes a capital improvement, the Defense Agency records the capital improvement in the applicable property records. The Defense Agency reports the depreciation and capital improvements on its financial statements. Supporting documentation such as work orders, construction contracts, and purchase invoices must be available to support the financial statements' reporting of capital improvements made.

When an entity performs maintenance or repair work, it is not considered capital improvements, regardless of whether the cost equals or exceeds the Department's financial capitalization threshold of \$100,000. Maintenance or repair work is recorded as an expense.

It is important to understand these rules so assets and improvements are properly recorded on the appropriate entity's financial statement.

Let's move on and discuss some exceptions to preponderant use.



## Rights and Obligations (cont.)



### Exceptions to preponderant use rule:

- **If another federal agency is a tenant on an Army installation, the Army reports the building on its financial statement**
- **When DoD medical facilities are located on Military Installations, the Military Department that owns the installation reports the facility on its financial statement**

There are some exceptions to the preponderant use of assets. When another federal agency is a tenant on an installation, and it is the predominant user of the building, the installation should report the use of the building on its financial statement.

In addition, the preponderant policy does not apply to DoD medical facilities. Most of the funding for medical activities is centralized through the Office of the Under Secretary of Defense (Health Affairs) (OUSD (HA)); the OUSD (HA) does not exercise command and control authority over medical activities.

Different types of medical facilities are located at Military Installations or are otherwise under the command and control of one of the Military Departments. The medical mission is to serve the personnel and families at or near the Military Installation.

Therefore, the installation is the preponderant user of the facility, and the medical facility, and all of the medical General PP&E, should be reported on the annual financial statements of the Military Department that owns the installation upon which the medical facility resides.

Let's move on to the management assertion Valuation or Allocation.



## Valuation or Allocation



### Valuation or Allocation Category, Example A

Assertion	Risk	Necessary Control	Test of Control
Valuation or Allocation	Over-valued property	Obtain supporting historical cost information or approved estimates to support the stated value	Recalculate the estimates

An assertion made by management about valuation or allocation addresses whether the assets, liabilities, equity, revenues, and expenses have all been included in the financial statements at the appropriate value.

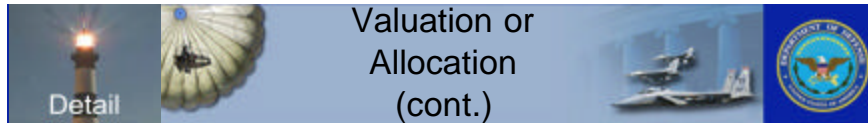
For example, the Department asserts that the PP&E is recorded at historical costs and that costs are systematically allocated to the appropriate accounting periods. The auditor ensures that the property was valued correctly and that the amount was authorized. In addition, the Department asserts that Accounts Receivable shown on the Balance Sheet is stated at its Net Realizable Value (NRV).

Example of potential misstatement: Over-valued property.

Internal control: Obtain supporting historical cost information or approved estimates to support the stated value.

Test of control: Recalculate the estimates.

Let's look at examples of valuation or allocation with a FBWT formula.



## Valuation or Allocation Category, Example B

Assertion	Risk	Necessary Control	Test of Control
Valuation or Allocation	Under-valued Defense Environmental Restoration Program (DERP) liabilities	Obtain supporting historical cost estimates or approved engineering estimates to support the stated value of the clean up	Recalculate the estimates Validate supporting documentation

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Four categories of background information on Environmental Liabilities support the valuation or allocation assertion. These four categories are assumptions, quantities, cost elements, and project changes.

Assumptions refer to a reasonable estimate of the needed items that are anticipated, but actual amounts are unknown at the time the estimate is being completed. Quantities are amounts needed for a particular physical aspect. Cost elements include the cost to purchase a particular physical aspect, individual costs associated with the cost/estimate, and recognition of the addition or removal of cost when the project is funded. Project changes require justification on any increase or decrease to the project costs that need a written approval.

The example shown is a risk realized in the valuation of Environmental Liabilities, the control, and the test of that control.

Let's discuss the last management assertion, Presentation and Disclosure, a telling point with our financials.





## Presentation and Disclosure



### Presentation and Disclosure Category Example

Assertion	Risk	Necessary Control	Test of Control
Presentation and Disclosure	FBWT is not properly classified and described in the financial statements.	1. Agency staff reconciles Treasury Undisbursed Appropriation Account and Receipt Account trial balances to the G/L accounts.  2. The Chief Accountant reviews the FBWT account analysis and crosswalk to the financial statements against the Treasury Financial Management Supplement– U.S. Government Standard General Ledger (section V).	View reconciliation and check that FBWT is properly classified and described in the financial statements.

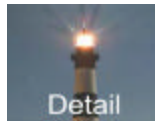
An assertion made by management about presentation and disclosure addresses whether particular components of the financial statements are properly classified, described, and disclosed.

For example, the Department asserts that the amount presented in its financial statements include a building either at the point of being signed for at construction completion or at various stages of completion, recording the work in progress.

The above example of presentation and disclosure is found in the GAO/PCIE FAM and addresses a risk in the FBWT line.

All of the five categories of assertions are important. From the Department's assertions, the auditor develops audit objectives and designs substantive tests.

Now let's discuss the Presentation and Disclosure assertion in relation to some of the material lines.



## Presentation and Disclosure (cont.)



### Minimum disclosures required:

- Cost, associated accumulated depreciation, and book value
- Estimated useful life
- Depreciation method
- Capitalization threshold, including any changes in threshold during the period

Note 10. General PP&E, Net						
As of September 30	2004				2003	
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	(91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	lease term 2-5 Or 10	139.1	(96.3)	42.8	96.2
D. Software	S/L	10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease <sup>1</sup>	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,388,610.3	\$ (947,711.7)	\$ 440,898.6	\$ 446,308.9
<sup>1</sup> See Note 15 on Capital Lease Liability for additional information						
Report on Depreciation Methods						
S/L = Straight Line N/A = Not Applicable						

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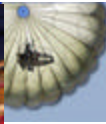
L3-36

Note 10, General PP&E, Net, provides detailed information to support Line item 1F, General PP&E, on the Balance Sheet. This note contains the major classes of General PP&E that are reported by the Department. Some examples of major classes of General PP&E include, but are not limited to: Land, Buildings, Structures, and Facilities; Leasehold Improvements; Software; General Equipment; Military Equipment; Assets Under Capital Lease; and Construction-in-Progress (CIP). The minimum disclosures required for each major class of General PP&E are:

- cost, associated accumulated depreciation, and book value
- estimated useful life
- methods of depreciation
- capitalization threshold, including any changes in threshold during the period
- restrictions on the use or convertibility of General PP&E.

SFFAS No. 1, Significant Accounting Policies, issued in July 2003 states that depreciation is computed using the straight line method. Net Book Value of multi-use heritage assets is now included in General PP&E, while physical quantity information is included in the Heritage Assets section of Required Supplemental Stewardship Information.

Let's discuss the risks involved with the Presentation and Disclosure category of Military Equipment in lieu of SFFAS No. 23.



## Presentation and Disclosure (cont.)



### Presentation and Disclosure Category Risks

Assertion	Risk	Necessary Control	Test of Control
Presentation and Disclosure	National Defense PP&E is not properly reported	1. Costs are capitalized and depreciated 2. Initial capitalization is based on historical costs including major improvements or modifications 3. Manually collect budgetary and expenditure data 4. Total estimated procurement costs divided by items acquired 5. Depreciation is based on useful life and when place in service 6. Use transaction based valuation approach for contracts awarded in FY 2007	A sample of past and future Military Equipment acquisitions is taken and the method of evaluation is validated

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One of the problem areas in presentation and disclosure is associated with the newly established line for Military Equipment.

Before the category of National Defense PP&E was eliminated, the acquisition costs were expensed in the period incurred. Now, costs of these types are capitalized and depreciated (except for land and land improvements). The initial capitalization should be based on the item's historical costs including any major improvements or modifications. SFFAS No. 23 contains additional details on how to treat this category.

Audits have revealed that the Department is not reporting the cost of Military Equipment in accordance with Generally Accepted Accounting Principles (GAAP), primarily due to the lack of historical cost information.

In 2003, the Department used estimates that were based on those compiled by the Bureau of Economic Analysis and finally were able to place a value on Military Equipment at \$1.1 trillion and a net book value of \$328 billion. Still, this value could not be tied to actual costs or linked to source documents. The answer to this note is a Work in Process (WIP) and includes the approach described on the next slide.



## Presentation and Disclosure (cont.)



### **The approach towards an auditable valuation and disclosure of Military Equipment includes:**

- **Development of business rules**
- **Establishment of baseline valuations**
- **Transaction-based valuation approach**

**<http://www.acq.osd.mil/me/overview/article.htm>**

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The business rules include full cost, Research, Development, Test, and Evaluation (RDT&E), cleanup costs, classification, modifications (modernizations, upgrades, and improvements), contract close-out adjustments, acquisition date and useful life, reporting entity, and componentization.

These rules are centered on defining what types of Military Equipment assets must be capitalized and how to value them. In general, a tangible asset must be capitalized if the full cost of the asset equals \$100,000 or more, if it has an estimated useful life of two years or more, if it is for use by the entity, and if it is not for sale in the ordinary course of business.

Baseline evaluation involves manually collecting budgetary and expenditure data from accounting systems, budget reports, and other documents. The value is determined by dividing the total estimated procurement costs of a program by the items acquired (actual or projected through FY 2006). Depreciation is based on useful life and when placed in service.

Finally the transaction-based valuation approach is designed to satisfy the FASAB requirements to value Military Equipment by requiring information (processes, systems, and data) derived from accounting transactions, invoices, and other authoritative documents that support the actual costs of assets be included in contracts awarded in FY 2007.

Both Military Equipment valuation and disclosure assertions are being proactively addressed.

Let's summarize what we learned in this lesson.



## Lesson Summary



- **Risk as Associated with Materiality**
- **Analysis of Risk**
- **Existence or Occurrence**
- **Completeness**
- **Rights and Obligations**
- **Valuation or Allocation**
- **Presentation and Disclosure**

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In this lesson, you learned about materiality and its relationship to risk with the view that each Component, agency, and unit have differing perspectives on what is or isn't material to their operations. You also learned about risk analysis and where it fits in the development of internal control.

You also looked at the assertions tested by auditors to give you a perspective on the assertion process itself. You saw how each assertion addresses a number of risks that must be mitigated by an internal control and then validated with a test of each control.

The following slides list references available for additional information.



## References



**PAR:** <http://www.defenselink.mil/comptroller/par/>

**FFMIA:**

<http://www.dod.mil/comptroller/icenter/inforef/ffmia96.pdf>

**Inspector General Act:** <http://www.ignet.gov/>

**CFO Act:** [http://www.gao.gov/policy/12\\_19\\_4.pdf](http://www.gao.gov/policy/12_19_4.pdf)

**TFM:** <http://fms.treas.gov/tfm>

**DoDFMR:** <http://www.dod.mil/comptroller/fmr/>

**FMFIA:**

<http://www.whitehouse.gov/omb/financial/fmfia1982.html>



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**OMB Bulletin Nos. 01-02 and 01-09:**  
<http://www.whitehouse.gov/omb/bulletins/>

**GAO Government Auditing Standards:**  
<http://www.gao.gov>

**FASB GAAP:** <http://www.fasb.org>

**DoD OIG:** <http://www.dodig.osd.mil>

**OMB Circular Nos. A-123 and A-127:**  
<http://www.whitehouse.gov/omb/circulars/>

**Air Force Audit Agency:** <http://www.affaa.hq.af.mil/>

**Naval Audit Service:** <http://www.hq.navy.mil/NavalAudit/>



## References (cont.)



**FASAB Standards:** <http://www.fasab.gov/standards.html>

**FASAB Concepts:** <http://www.fasab.gov/concepts.html>

**Army Audit Agency:** <http://www.hqda.army.mil/aaaweb/>

**DoD Directive 5010.38:**

[http://www.dtic.mil/whs/directives/corres/pdf/d501038\\_082696/d501038p.pdf](http://www.dtic.mil/whs/directives/corres/pdf/d501038_082696/d501038p.pdf)

**DoD Instruction 5010.40:**

[http://www.dtic.mil/whs/directives/corres/pdf/i501040\\_082896/i501040p.pdf](http://www.dtic.mil/whs/directives/corres/pdf/i501040_082896/i501040p.pdf)





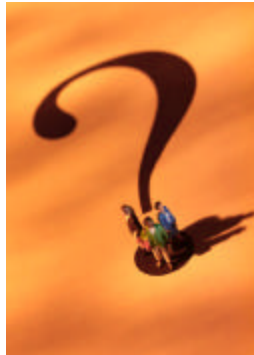
## References (cont.)



**DSMC Risk Management Guide for DoD Acquisition:**  
**[http://www.mitre.org/work/sepo/toolkits/risk/references/  
files/DSMC\\_RiskMgmt\\_Guide.pdf](http://www.mitre.org/work/sepo/toolkits/risk/references/files/DSMC_RiskMgmt_Guide.pdf)**

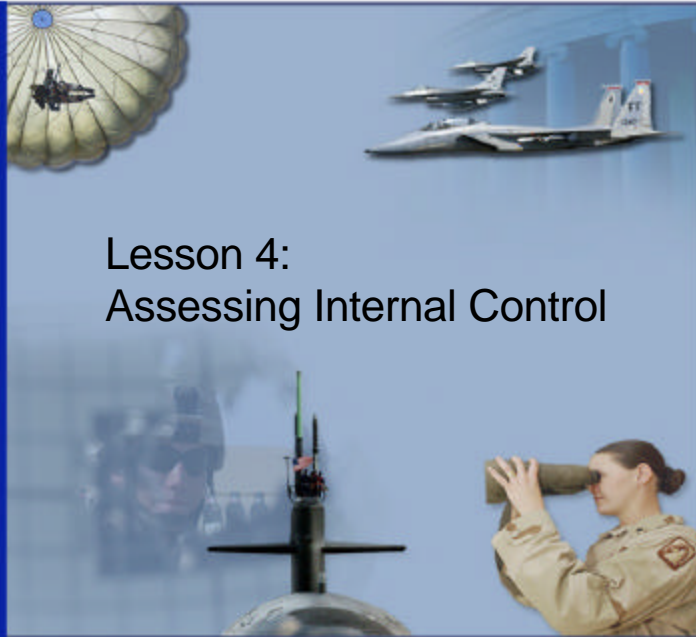


## Questions



Before we move on Lesson 4, Assessing Internal Control, do you have any questions on the material covered in this lesson?

Effective  
Internal  
Control  
for Financial  
Reporting



## Lesson 4: Assessing Internal Control

In Lesson 4, we will examine how internal control is assessed and whether the internal control system in place is designed to address the risk associated with material weaknesses found in the categories of Real Property, Military Equipment, Environmental Liabilities, and Fund Balance With Treasury (FBWT).

Let's discuss the objective of this lesson.



## Lesson Objective



**Upon successful completion of this lesson, you will be able to evaluate whether proper controls are in place.**

This lesson will break down the process of evaluating your internal control program. Evaluating your internal control program is important because you will be able to see if the controls that you have in place will assure you that your operations and reporting are being effectively and efficiently executed and will corroborate your assertions in your statement of assurance.

Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs. This continuous monitoring, and other periodic assessments, should also provide the basis for the agency head's annual assessment of and report on internal control, as required by the Federal Manager's Financial Integrity Act (FMFIA).



## Lesson Topic



**This lesson contains the topic of Internal Control Assessment.**

In this lesson, we discuss how we know whether or not the internal control program in your organization is doing what it should. Is your program providing you reasonable assurance that, for example, the information reported in your financial reports is reliable?

Management has primary responsibility for assessing and monitoring controls, and should use other sources as a supplement to, not a replacement for, its own judgment.

Let's see what makes up the internal control assessment process.



## Internal Control Assessment



### **Assess internal control by:**

- **Reviewing applicable sources of information**
- **Establishing a Senior Assessment Team (SAT)**
- **Evaluating internal control at the entity level**
- **Evaluating internal control at the process, transaction, or application level**
- **Assessing the design and operation of internal control over financial reporting**

### **Assess internal control over financial reporting by its ability to support your assertions**

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We have laid the framework for assessing internal control. Now, let's look at what you are assessing in your evaluation of your internal control over financial reporting. Remember that you must be able to support your assertions. Without an adequate internal control program, there is an increased likelihood that your financial report balances are misstated.

Your control activities provide reasonable assurance that all reported transactions actually occurred and your assets and liabilities exist during the reporting period; all assets, liabilities, and transactions are reported and no unauthorized transactions or balances have been included; all assets are legally owned by you and all liabilities are your legal obligations; all assets have been safeguarded against fraud, waste, and abuse; and all assets and liabilities have been properly valued or allocated. Control activities also provide reasonable assurance that your financial report is presented in the proper form and any required disclosures are present; your transactions are in compliance with applicable laws and regulations; and your documentation for internal control, transactions, and other significant events is readily available for examination.

The only way you can provide assurance is by having an assessment process in place. First, let's cover sources of information.



## Internal Control Assessment (cont.)



### Sources of Information

- **Management knowledge**
- **Management reviews**
- **Inspector General (IG)**
- **Government Accountability Office (GAO) reports**
- **Program evaluations**
- **Audits of financial statements**
- **Reviews of financial systems**

The agency head's assessment of internal control can be performed using a variety of information sources. Management knowledge is gained from the daily operation of agency programs and systems. Management reviews are conducted expressly for the purpose of assessing internal control, or for other purposes with an assessment of internal control as a by-product of the review. Inspector General (IG) and Government Accountability Office (GAO) reports include audits, inspections, reviews, investigations, outcome of hotline complaints, or other products. Program evaluations will assist in identifying controls and provide a measure of their effectiveness.

Audits of financial statements conducted pursuant to the (Chief Financial Officers) CFO Act, as amended, include: information revealed in preparing the financial statements; the auditor's reports on the financial statements, internal control, and compliance with laws and regulations; and any other materials prepared relating to the statements. Reviews of financial systems which consider whether the requirements of the Federal Financial Management Improvement Act (FFMIA) and the Office of Management and Budget (OMB) Circular No. A-127 are being met.

Other sources of information are discussed next.



## Internal Control Assessment (cont.)



### Sources of Information (cont.)

- **Federal Information Security Management Act (FISMA)**
- **Office of Management and Budget (OMB), Circular A-130**
- **Government Performance and Results Act (GPRA)**
- **Program Assessment Rating Tool (PART) assessments**
- **Improper Payments Information Act (IPIA) reports**
- **Single audit reports for grant-making agencies**
- **Congressional reports**
- **Agency reviews or reports**
- **Results from tests of key controls**

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Other sources of information include annual evaluations and reports pursuant to Federal Information Security Management Act (FISMA) and OMB Circular No. A-130, and annual performance plans and reports pursuant to the Government Performance and Results Act (GPRA) and Program Assessment Rating Tool (PART) assessments and annual reviews and reports pursuant to Improper Payments Information Act (IPIA).

Other sources of information include single audit reports for grant-making agencies and reports and other information provided by the Congressional committees of jurisdiction. Other reviews or reports relating to agency operations include those for the Department of Health and Human Services and quality control reviews of the Medicaid and Temporary Assistance for Needy Families programs.

The internal control evaluation generates results, for example, from tests of key controls performed as part of the assessment of internal control over financial reporting conducted in accordance with the requirements. Use of a source of information should take into consideration whether the process included an evaluation of internal control. Agency management should avoid duplicating reviews which assess internal control, and should coordinate their efforts with other evaluations to the extent practicable.

If a federal manager determines that there is insufficient information available upon which to base an assessment of internal control, then appropriate reviews should be conducted which will provide such a basis.

Now let's look at why we assess internal control.





## Internal Control Assessment (cont.)



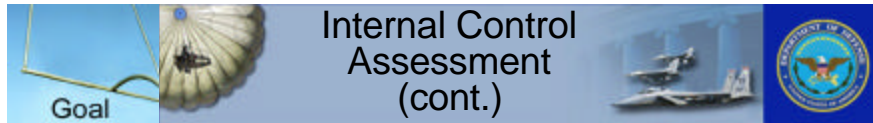
### Financial reporting internal control:

- **Ensures that transactions are properly recorded, processed, and summarized**
- **Safeguards assets against loss from unauthorized acquisition, use, or disposition**

If you've kept up with an on-going assessment of your internal controls, you can be sure that your audit will proceed. In financial reporting, auditors look to see that Generally Accepted Accounting Principles (GAAP) are applied to transactions. These recordings are the basis for the information that is contained in financial statements.

Financial reporting internal controls safeguard assets against loss from unauthorized acquisition, use, or disposition. An example of financial reporting internal control is the requirement for separation of duties.

Let's talk about operations internal control.



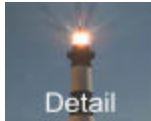
**Operations internal control strives to maintain the effectiveness and efficiency of policies and procedures in place to carry out the organizational mission.**

**Operations internal control includes ensuring that data cannot be inappropriately manipulated.**

Organizations need to have published policies and procedures, local guidance, and SOPs that serve as a framework for management to carry out organizational objectives, such as planning, productivity, programming, quality control, economy, efficiency, and effectiveness. The auditors' review ensures that operations internal control provides reasonable certainty that the entity achieves its mission and maintains quality standards in a effective and efficient manner.

Systems administration, access, and separation of duties controls are not only in the accounting operations, but also in system security. In each case, you are using a system as the main facilitator for your requirements. As part of the internal control process, observation of these processes allows you to evaluate their effectiveness and ascertain whether or not adjustments to the controls are needed.

Now that we understand the basis for assessment, let's look at the responsibilities of a Senior Assessment Team (SAT).



## Internal Control Assessment (cont.)



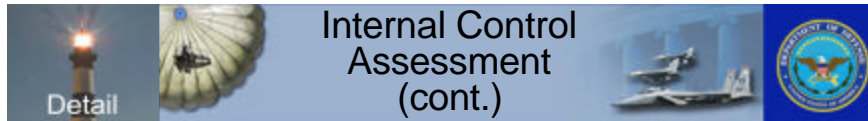
### Establish a senior assessment team to:

- **Determine scope of assessment (risk and internal control)**
- **Ensure that assessment objectives are clearly communicated**
- **Ensure that assessment is carried out in a thorough, effective, and timely manner**
- **Determine assessment design and methodology**
- **Document everything**

The success of your organization's assessment will largely depend on who will be responsible for carrying out or directing the assessment. Given the importance of the assessment, a SAT should be established that derives its authority and support from the head of your agency or from your Chief Financial Officer (CFO). It is recommended that the team be a subset of your senior management council. The SAT could also take on the form of a financial management improvement committee.

At a minimum, a SAT must initially determine the scope, design, and methodology for the assessment. The team must then identify the needed funding and resources for carrying out the assessment. They have the responsibility of communicating the objectives of the assessment. This establishes the ground work for the assessment and ensures its success. The SAT must also ensure that the assessment is carried out thoroughly, effectively, and in a timely manner. Finally, remember to document everything, establishing a audit trail to underwrite your Statement of Assurance (SOA) on internal control. For reporting on internal controls over financial reporting, the SAT would perform the same responsibilities. Establishment of a SAT is required by DoD for subcomponents that prepare stand-alone financial statements.

Let's look at the role and composition of the senior management council.



### **Role of a Senior Management Council**

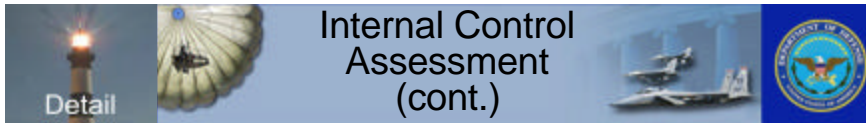
**A Senior Management Council, which may include the CFO, the Senior Procurement Executive, the Chief Information Officer, and the managers of other functional offices, should be involved in identifying and ensuring correction of systemic weaknesses relating to their respective functions.**

The Senior Management Council may be comprised of the CFO, the Senior Procurement Executive, the Chief Information Officer, and other managers. Consideration should be given to involving the IG in a consulting capacity but not to conduct management's assessment of internal control. The council generally recommends to the agency head which reportable conditions are deemed to be material weaknesses to the agency as a whole, and should therefore be included in the annual FMFIA assurance statement and reported in the agency's Performance and Accountability Report (PAR).

The Senior Management Council should be responsible for overseeing the timely implementation of corrective actions related to material weaknesses. Such a council may also be useful in determining when sufficient action has been taken to declare that a reportable condition or material weakness has been corrected.

While the establishment of such a council is not a requirement of the OMB Circular A-123, a Senior Management Council or similar construct is encouraged.

Next, let's discuss the process, transaction, or application-level internal control assessment.



**Evaluate internal control at the process, transaction, or application level by:**

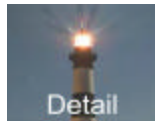
- **Determining significant accounts or groups of accounts**
- **Identifying and evaluating the major classes of transactions**
- **Understanding your business processes**
- **Understanding the financial reporting process**

For each financial report identified in the scope of the assessment, identify those business events, accounts, or groups of accounts that individually or collectively could have a material effect on the financial report. Agencies should consider qualitative as well as quantitative measures to determine material items.

For each significant business event, account, or group of accounts, identify the major classes of transactions that materially affect those accounts or business events. In identifying transactions, specifically consider whether a class of transactions is routine, non-routine, or represents an accounting estimate. This type of classification can help the senior assessment team identify the inherent risk and the controls necessary to adequately mitigate such risks. The assessment should include obtaining an understanding of the specific processes and document flow involved in each class of transactions. Thoroughly understanding the processes and document flow will help in understanding where errors could occur and what control objectives and techniques may prevent or detect those errors.

Obtain an understanding of the process and workflow that link the accounting system to the financial reports. Often times, financial information is not directly transferable from the accounting system to the financial report, but requires intervening calculations and summarizations. This represents another point where errors can be introduced into the financial report, and it is important to understand where such errors could occur and what control objectives and control techniques can prevent or detect these errors.

Let's continue discussing more ways to evaluate internal control at the process, transaction, or application level.



## Internal Control Assessment (cont.)



### Evaluate internal control at the process, transaction, or application level by (cont.):

- **Gaining an understanding of control design to achieve management's assertions**
- **Assessing controls to ensure that they are adequately designed**
- **Testing controls and assessing compliance to support management's assertions**

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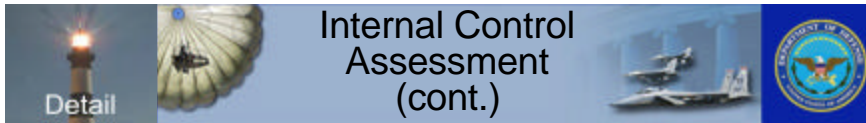
L4-12

Prepare control evaluations for each significant business event, account, or group of accounts that aligns specific controls with management's assertions for each account or group of accounts. An individual assessment of the potential effectiveness of the design of the controls for each account or group of accounts should be made considering the risk of error and the controls that are designed and in place to prevent or detect such errors. Assessing the effectiveness of the design of a control is concerned with whether the control is suitably designed to prevent or detect a material error related to an account or group of accounts. Procedures to obtain such evidential matter ordinarily include inquiries of appropriate agency personnel; inspection of documents, reports, or electronic files; and observation of the application of specific controls. This is sometimes referred to as a walk-through and helps the senior assessment team ensure its understanding of the controls. An assessment of the control design should identify controls as effective, moderately effective, or not effective.

If a control over a significant business event, account, or group of accounts is missing or its design is determined to be not effective considering the associated risk of error, the senior assessment team does not need to test this control for the purpose of concluding on control effectiveness. This instance should be noted in the report of deficiencies and suggestions for improvement. However, management may nevertheless seek to further test affected transactions to determine if there was any actual loss, fraud, error, improper payment, or noncompliance resulting from those ineffective controls.

For those controls whose design is deemed effective or moderately effective, the senior assessment team should test those controls to determine the extent to which the controls were applied, the consistency of their application, and who applied them. Tests of controls ordinarily include procedures such as inquiries of appropriate agency personnel; inspection of documents, reports, or electronic files, indicating performance of the control; observation of the application of specific control; and reperformance of the application of the control by the senior assessment team. If testing indicates that a significant control is not operating as designed, it should be reported as a deficiency.

Finally, let's examine the last phase of internal control assessment, the design and operation of internal control over financial reporting.



**Evaluate internal control at the process, transaction, or application level by (cont.):**

- **Assessing the design and operation of internal control over financial reporting**

The final step in the internal control assessment is an overall conclusion as to the design and operation of the internal controls over financial reporting based on the assessments at the entity level and the process, transaction, or application level. The overall assessment should conclude whether the internal controls over financial reporting are operating effectively or whether material weaknesses exist in the design or operation. Use DoD Internal Control Assessment forms when performing assessments to support your Statement of Assurance on Internal Control over Financial Reporting.

In addition, an assessment of internal control over financial reporting should be coordinated with other activities to avoid duplication of efforts with similar activities. For example, agencies are required to perform reviews of financial systems under FFMA or information security under the FISMA. Reviews performed by management, or at management's direction, may be used to help accomplish this assessment. Management may consult with the Agency IG to plan and coordinate related work. The IG may be involved in a consulting capacity, but must not conduct management's assessment of internal control over financial reporting.

Control weaknesses at a service organization could have a material impact on the controls of the customer organization. Therefore, management of cross-servicing agencies will need to provide an annual assurance statement to its customer agencies in advance to allow its customer agencies to rely upon that assurance statement. Management of cross-servicing agencies must test the controls over the activities for which it performs for others on a yearly basis. These controls must be highlighted in management's assurance statement that is provided to its customers. Cross-servicing and customer agencies will need to coordinate the timing of the assurance statements.

Now let's summarize what we learned in this lesson.



## Lesson Summary



### Internal Control Assessment

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In this lesson, you learned about how to evaluate internal control in your organization through an internal control assessment process. By having a team drive the internal control assessment process, you can be reasonably assured the information that you are providing to your customer, the Department, and your auditor is reliable.

The following slide lists references available for additional information.





## References



**GAO/PCIE FAM:**

**<http://www.gao.gov/special.pubs/gaopcie/>**

**GAO Standards for Internal Control in the Federal Government:**

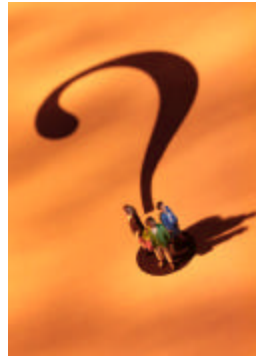
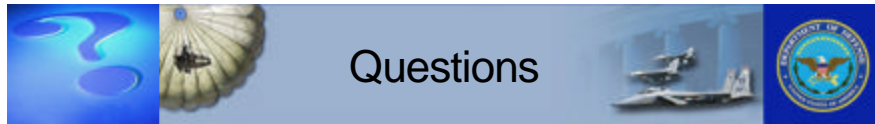
**<http://www.gao.gov/special.pubs/ai00021p.pdf>**

**Checklist for Reviewing Systems under the FFMIA:**

**<http://www.gao.gov/new.items/d05225g.pdf>**

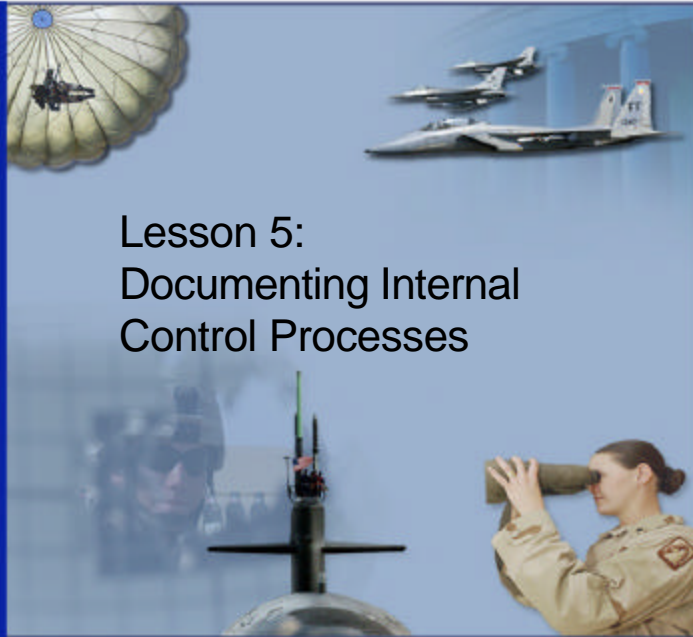
**OMB Circulars:**

**<http://www.whitehouse.gov/omb/circulars/>**



Before we move to Lesson 5, Documenting Internal Control Processes, do you have any questions on the material covered in this lesson?

Effective  
Internal  
Control  
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Reporting



Lesson 5:  
Documenting Internal  
Control Processes

In this lesson, we will identify the necessary documentation requirements for internal control and explain why they are important. As we cover internal control documentation requirements, we will relate the requirements to Real Property, Military Equipment, Environmental Liabilities, and Fund Balance with Treasury (FBWT) where applicable in the lesson.

Let's look at the lesson objective.



## Lesson Objectives



**Upon successful completion of this lesson, you will be able to explain internal control documentation requirements.**

This lesson explains documentation requirements for the internal control processes. Documentation requirements such as Standard Operating Procedures (SOPs), flow charts, cycle memos, audit trails, and responsibility for Internal Control Plans are covered in this lesson.

Lets continue by looking more closely at the lesson content.



## Lesson Topics



**This lesson contains the following topics:**

- **Standard Operating Procedures (SOPs)**
- **Flow Charts**
- **Audit Trails**
- **Responsibility for Internal Control Plans**

In this lesson, we discuss the documentation that supports an internal control program including SOPs, flow charts, and audit trails. This lesson also covers who is responsible for the Internal Control Plan.

SOPs provide direction and guidance on responsibility, procedures, nomenclature, and regulatory guidance for internal controls. The SOPs topic also contains examples of forms and reports.

The Flow Charts topic covers how the flow chart plays an important part in the assertion process. Audit trails and their requirements will be discussed, using examples of documents that are generated at various points within your processes, as the basis for your audit trail. Finally, we will cover responsibility for your Internal Control Plans.

Let's begin with a document that is the foundation for a good internal control program, the SOP.



## Standard Operating Procedures



**The scope of an internal control SOP must include:**

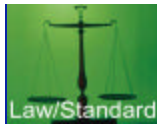
- **The activity's methods and measures used to achieve the organization's internal control objectives (including both the controls and the evaluation of those controls)**
- **An inventory of the assessable units covered, responsibilities, the regulatory guidance, and their schedules**

The scope of an SOP on internal control must be inclusive of the activity's methods and measures used to achieve the organization's internal control objectives (effectiveness and efficiency of operations, reliability of financial reports, and compliance with applicable laws and regulations), both the controls and the evaluation of those controls. It must also contain an inventory of the assessable units covered, responsibilities, the regulatory guidance, and the requisite reports and their schedules.

Agency management must determine the appropriate level of documentation needed to support this assessment. Documentation should be appropriately detailed and organized and contain sufficient information to support management's assertion.

Documentation should also include appropriate representations from officials and personnel responsible for monitoring, improving, and assessing internal control. Specific assessment and documentation requirements to support management's assurance statement on internal control over financial reporting are defined in Appendix A of the OMB Circular A-123.

Let's first consider what SOPs cover.



## Standard Operating Procedures (cont.)



### **SOPs must:**

- **Provide detailed descriptions of locally used procedures**
- **Describe and justify deviations from higher headquarters procedures**
- **Provide process standardization**
- **Provide details that form a basis for the process described in a cycle memo**

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SOPs provide a detailed description of locally used procedures. Any deviation from the higher level approved procedures must be clearly described, justified, and approved in writing. SOPs provide standardization of certain processes. They complement regulatory guidance and are used to direct processes within the organization towards regulatory compliance.

Some examples of items found on an SOP for the DFAS Vendor Pay Product Line are that deviations must receive approval from the Director of Resource Management. This SOP also requires the use of the Standard Document Number (SDN) as the obligation reference number and a government purchase card as a payment instrument for goods and services. The example SOP uses special externally certified payment procedures for attorney fees, apprehension awards, reimbursements, confinement costs, awards for suggestions, child care, claims from Class A agents, and clothing. In the analysis of your procedure, SOPs provide details, such as policies and procedures for processing cycle transactions, that can be used to develop a cycle memo.

The importance in covering this information is that it is essential to explain regulatory guidance at the activity level, and the SOP provides the methods of operation.

Let's take a look at some of the explicit and implicit guidance found in a Navy SOP on internal control.

  <div style="text-align: center;"> <h2>Standard Operating Procedures (cont.)</h2> </div>  	
<h3>2004 Navy Internal Control SOP</h3>	
<b>STANDARD PROCEDURES</b>	PROCEDURES NO./J.O. NO. 7310.126
CHECK ONE <input checked="" type="checkbox"/> Operating <input type="checkbox"/> Administrative <input type="checkbox"/> Job Outline <input type="checkbox"/> Policy Statements <input type="checkbox"/> Management Guidelines	ORGANIZATION CODE: DFAS-ADB/CL
SUBJECT Accounting Services Navy Management Control Program (MCP) Procedures and Guidelines	REVISION NO. 1
	DISTRIBUTION: Accounting Services Navy
	SUPERSEDES 10/01/03

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An excellent example of an internal control SOP is included in Appendix B. As we look at this example, the introduction addresses the rationale for the SOP, the inclusiveness of its audience, and the regulatory guidance. The Purpose and Scope section states that the purpose of this procedure is to implement policy and guidance in support of the established Defense Finance and Accounting Service (DFAS) Management Control (MC) Program, with particular emphasis on standardized documentation, tracking, and reporting requirements expected within the Accounting Services - Navy. This example SOP applies to management and support staff within the Accounting Services - Navy. This Purpose and Scope section states that it will be used in conjunction with the guidance set forth in DFAS 5010.38-R, Federal Managers' Financial Integrity Act (FMFIA), Section 2, Management Control Program, May 2002.

The SOP covers the plans, methods, and procedures used to meet mission, goals, and objectives to prevent and correct fraud, waste, abuse, and mismanagement. The SOP outlines who must implement the internal control program and addresses the overall objective of internal control which is that the program provide reasonable assurance that the objectives of FMFIA are met using a model based on assessable units. The SOP states that managers will continuously monitor, evaluate, and improve the effectiveness of the system of MCs and processes.

The Introduction section of this SOP states that the ultimate goal of this SOP is to provide the Accounting Services - Navy management and support staff with the appropriate guidance to ensure MC Program requirements are met and that the appropriate criteria for standardized reporting and documentation are followed. SOPs, as internal control, are not etched in stone. Re-evaluation and scheduled assessments of their effectiveness are necessary.

Now let's look at the decision points for internal control by reviewing flow charts.

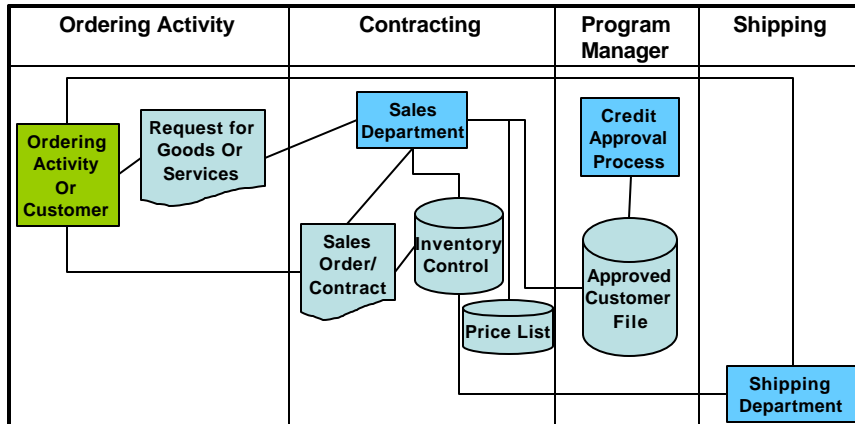




## Flow Charts



**Flow charts are a component of cycle memos.**



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Remember from our earlier discussion that flow charts are integral to risk analysis and are a useful tool for process analysis. In addition, flow charts are also a starting point in an assertion package checklist. A flow chart helps you to visualize your entity's processes, recognize risk, and identify internal controls and lack thereof. A flow chart can be the basis of SOP development.

Let's consider a few helpful practices.



## Flow Charts (cont.)



### Helpful practices in evaluating your processes:

- **Think like an auditor**
- **Develop a good method for organizing documentation, using document review products such as Electronic Document Access (EDA)**
- **Establish clear audit trails and keep a copy of the databases**

These helpful practices may assist you in evaluating your processes. To begin, you must think like an auditor. This includes the use of audit checklists, references, and tools that an auditor would use to assess the information that you supply. Procedures used by auditors rarely call for in-depth analysis or complicated calculations. Audit opinions are based on solid research of your policies, practices, and procedures, in addition to the financial information you report.

To ensure that others may reach the same conclusion, using the same data set and validation methods, a good method for organizing documentation is needed. Products such as Electronic Document Access (EDA) can help in reviewing documents.

Organizations that obtain favorable audit opinions have established clear audit trails. Once audit trails are established, records of documentation testing procedures can be maintained to substantiate audit readiness. It is a good idea to keep a copy of the databases used in your analysis of financial information. Conclusions drawn using a particular set of data may not be valid when the data changes during the next accounting cycle, though the procedures for gathering that data should not change from one period to the next.

Let's discuss the audit trail.



## Audit Trails



### What is an audit trail?

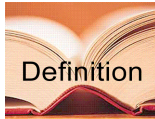
**Refers to the documents, journals, ledgers, worksheets, reports, statements, and so forth, by which an original transaction can be traced forward to a summarized total, or a summarized total can be vouched backward to the original transaction.**

An audit trail documents the processing of source transactions into feeder systems, through the accounting system, to the financial statements. An audit trail must be traceable.

An analogy to the audit trail can be seen in the following example. If I were to ask you to give me a 24-hour head start, then follow and find me, you would have a very difficult time unless, of course, I provide you with some directions, a map, or perhaps my destination. What could make matters worse is if I should provide you with the wrong map, inaccurate directions, and an unreliable compass. You could be chasing me forever without finding me.

The same can be said for the balances an auditor must examine during the annual financial statements audit. They may know that a certain transaction ought to have specific documentation to support it, but if documentation is missing or inaccurate, it can lead the auditor to the wrong destination.

Let's take a look at how the Department of Defense Financial Management Regulation (DoDFMR) describes an audit trail.



## Audit Trails (cont.)



**The DoDFMR requires that adequate documentation be maintained for an effective audit trail. An audit trail enables the tracing or replicating of a transaction from its source to the resulting record or report, and from the resulting record or report to the source.**



The DoDFMR states that a key test of the adequacy of an audit trail that is anyone can trace the transaction forward or backward and still verify the amount recorded or reported. It is the detailed proof that an event occurred and that it can be traced by someone else. Even though this description sounds simple enough, it is a major challenge for the Department.

Let's turn our attention to source documentation now.

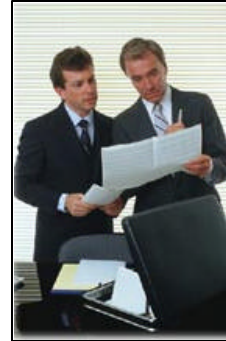


## Audit Trails (cont.)



**All Property, Plant, and Equipment (PP&E) transactions must be supported by source documents, including:**

- **Purchases, transfers, donations, or other means of acquisition**
- **Turn-in or disposal transactions**
- **Construction projects**



Using Property, Plant, and Equipment (PP&E) as an example, an audit trail is established with purchases, transfers, donations, or other acquisitions effective as of the placed-in-service date. Turn-ins or disposals are effective when PP&E leaves the owner's custody.

Proper documentation includes the physical quantity, location, and unit cost. The property records should be designed to assist making decisions related to procurement and use. This is especially important as related to potential excess PP&E that may be available for reuse, for transferring to another component, or for disposing.

One example of source documentation is the DD Form 1354, Transfer and Acceptance of Military Real Property. This form is used to show Construction-In-Progress (CIP) for posting upon completion of the project.

Let's look at supporting documentation for PP&E.



## Audit Trails (cont.)



**Copies of supporting documentation must follow the PP&E when it is:**

- Transferred to another activity
- Traded, sold, or disposed through salvage or demolition

Generally, supporting documentation must be retained at least 6 years and 3 months; however, Real Property has a different rule (10 years). Verify the specific retention periods for each type of PP&E documentation used.



NARA GRS: [http://www.archives.gov/records\\_management/records\\_schedules.htm](http://www.archives.gov/records_management/records_schedules.htm)

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It is important for copies of supporting documentation to accompany the General PP&E and continue to be retained in accordance with Volume 1, Chapter 9, of the DoDFMR and the National Archives and Records Administration (NARA).

When disposed of through salvage or demolition, a copy of the original acquisition documentation and disposal documentation must be retained per the applicable NARA instructions.

An example might include the transfer of a ship from the Navy to the Air Force. Supporting documentation must accompany the ship so that the Air Force can properly report it on their financial statements.

The General Records Schedule (GRS), found at the NARA GRS website, provides detailed guidance on record retention for every type of record maintained by the Department.

Let's discuss the specific requirements for the documentation that you use.



## Audit Trails (cont.)



**All supporting documentation will be retained:**

- **In accordance with the National Archives and Records Administration (NARA) General Records Schedule (GRS) and agency-specific instructions**
- **As original documents and/or hard or electronic copies in a readily available location**

**Typical kinds of documentation:**

- **Contracts, invoices, and disbursement documents**
- **DD Form 1354, Transfer and Acceptance of Military Real Property**
- **ENG Form 3013, Work Order/Completion Record**
- **Work orders**
- **Other third-party documentation**

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The DoDFMR, Volume 1, Chapter 9, also contains a link to the GRS website. In summary, it states that all supporting documentation should be retained in a readily available location. This means you already have to know what the auditors would need to see. Supporting documentation is also required to be retained for DoD-owned PP&E held by others and that of others held by DoD through seizure, forfeiture, loss, or abandonment. Records should allow validation of the acquisition cost, acquisition date, and any improvement costs and dates.

Typical kinds of documentation include contracts, invoices, disbursement documents; the DD Form 1354, the Engineer (ENG) Form 3013, Work Order/Completion Record; work orders; and other third-party documentation (generated independently of the entity in possession of the property).

Let's continue with required information on your documents.



## Audit Trails (cont.)



**Supporting documentation is required for both capitalized and expensed PP&E.**

**Leases equivalent to a purchase are capitalized, while operating leases are expensed.**



PP&E that does not meet the capitalization threshold, and is therefore expensed, must still be recorded in property accountability records (or systems) for control purposes if the cost is equal to or more than \$5,000. Also, PP&E that is considered sensitive and/or subject to pilferage, regardless of the cost, must be recorded in property accountability records.

Records must document the identity and maintain accountability for capitalized additions and improvements to PP&E.

Lease improvements documentation must also provide information to identify and account for leased PP&E, no matter if it was acquired by capital lease or operating lease, or whether the value exceeds the DoD capitalization threshold. Capital leases are considered equivalent to a purchase, while operating leases cover the use of an asset for a period of time and are treated by the lessee as periodic expenses.

Let's investigate a cold audit trail. The example we use is evidential matter on the cost basis of Military Equipment.





## Audit Trails (cont.)



**Value PP&E when documentation does not exist:**

- **For the cost of the PP&E**
- **For the accumulated depreciation**
- **Proportionate to the materiality and relative significance**
- **By using current working estimates prepared for acquisition**
- **By using appropriation or other Congressional information**
- **By using Plant replacement and improvement program documentation**
- **By using estimated cost of similar assets at the time of original acquisition**
- **By using current cost of similar assets discounted for inflation**

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Estimates must be made if supporting written or electronic documentation is not available.

The method of estimation and all details are important information to support the cost estimate documentation. Acceptable procedures for valuing PP&E for which historical cost documentation does not exist include current working estimates prepared for acquisition, appropriation or other Congressional information, plant replacement and improvement program documentation, development of an estimate based on the cost of similar assets at the time of the original acquisition, and current cost of similar assets discounted for inflation since the time of acquisition.

The effort put forth and the precision desired should be relative to the value and significance of the specific asset involved.

Invariably, changes have to be made to records due to extenuating circumstances. Let's pay particular attention to these adjustments and how they are handled. It can be a red flag for an auditor assessing your audit trail.

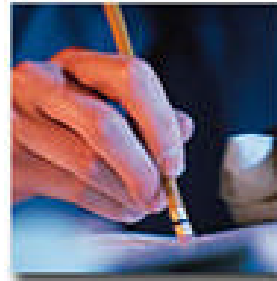


## Audit Trails (cont.)



### Adjustments to Records:

- Memorandums for Record
- Journal Vouchers (JVs)
- Other adjusting documents



**It is important to remember that errors are more likely in non-routine transactions, so pay particular attention when making adjustments.**

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There are several things to keep in mind anytime you need to make adjustments to a transaction. You should remember the consequences of that adjustment by providing adequate support to the adjustment. Detailed written documentation is needed to provide an audit trail to the source that requires the adjustment.

This documentation ought to include the rationale and justification for the adjustment, detailed numbers and dollar amounts of errors or conditions that are related to the transaction or record that is proposed for adjustment, the date of the adjustment, and the name and position of the individual approving the adjustment.

The adjustment process is a highly vulnerable process with high risk. Adjustment processes should be flowcharted and internal controls well documented to mitigate risk of misstatement.

It is important to remember that errors are more likely in non-routine transactions, so pay particular attention when making adjustments.

Finally, let examine the types of documentary evidence that establish your audit trails and in turn support your management assertions.



## Audit Trails (cont.)



### The Five Categories of Assertions

Evidence	Existence or Occurrence	Completeness	Valuation or Allocation	Rights & Obligations	Presentation & Disclosure
<b>PHYSICAL</b>					
Direct Inspection & Observation	X	X	X	X	
<b>TESTIMONIAL</b>					
Inquiries, Interviews, & Questionnaires	X	X	X	X	X
<b>DOCUMENTARY (Samples)</b>					
Relevant Laws & Agency Regulations	X		X	X	X
Documents of Public Record	X		X	X	X
Contracts, Agreements, Deeds, & Leases	X	X	X	X	
Certified Appraisals	X		X		X
Transfer & Shipping Reports	X	X	X	X	
Inventory Reports	X	X	X	X	X
Purchase Orders, Receiving Reports, Invoices	X	X	X	X	
Payment Vouchers, Checks or EFT #	X	X	X	X	
Maintenance Records	X		X		
System Reports & Client Prepared Schedules	X	X	X		
<b>ANALYTICAL</b>					
Comparisons, Ratios, Expected Relationships	X	X	X		

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This slide provides examples as to what category of assertions can be met by various types of evidence. The left column lists types of evidence (physical, testimonial, documentary, and analytical). The five columns to the right represent the five categories of assertions. This format provides the user a means of documenting evidential matter as it relates to the five categories of assertions.

Next, let's examine your responsibility for Internal Control Plans.



## Responsibility for Internal Control Plans



**Ultimately, you are responsible for the success of your entity's Internal Control Plan.**

**you**

You are responsible for your internal control plan. You must know where you fit in the processes described in the cycle memo and how your actions contribute to the overall health of the organization. In particular, you must understand where your outputs are reflected in financial reports and eventually into a line or more than one line in your financial statements.

Let's see how the Internal Control Plan evolves.



## Responsibility for Internal Control Plans (cont.)



### **Managers' Internal Control Program, Department of Defense Directive (DoDD) 5010.38:**

- **The Department will establish a Managers' Internal Control Program**
- **The Department will take action to identify and correct ineffective internal controls**
- **The Department will establish new internal controls as needed**

### **Managers' Internal Control Program Procedures, Department of Defense Instruction (DoDI) 5010.40:**

- **Develop a Managers' Internal Control Program**
- **Statement of Assurance**

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The Federal Manager's Financial Integrity Act (FMFIA) Over Financial Reporting Statement of Assurance is a subset of the FMFIA Overall Statement of Assurance. Only those entities that are required by either the Office of Management and Budget (OMB) or the DoD to prepare stand-alone financial statements (Financial Statement Reporting Entities (FSREs)) are required to provide a FMFIA Over Financial Reporting Statement of Assurance to the Secretary of Defense. Why do we need a statement of assurance of internal control? It is required by various government-wide regulations.

The Department of Defense Instruction (DoDI) 5010.40, Managers' Internal Control Program Procedures, implements the policy, assigns responsibilities, and prescribes procedures found in the DoD Directive 5010.38, Managers' Internal Control Program, the FMFIA, and the OMB Circular A-123. The DoD Directive 5010.38 states that the Department will establish a Managers' Internal Control Program and take action to identify and correct ineffective internal controls, and establish new ones when needed. The OUSD(C) manages the Managers' Internal Control (MIC) Program on behalf of the Secretary of Defense (SecDEF). Other Under Secretaries and Assistant Secretaries of Defense are charged to identify systemic internal control weaknesses in their functional areas that should be reported, and to review the material weaknesses and corrective action plans reported by Components.

The heads of the Components are also charged to develop and maintain their Managers' Internal Control Programs to conclude with the reporting of management's assurance to the Secretary of Defense by September 1st of each year about the effectiveness of its internal controls. This includes such things as assigning responsibilities, developing internal reporting and tracking abilities, ensuring periodic evaluations (or ongoing monitoring as just discussed in the Government Accountability Office (GAO) standards), and maintaining appropriate documentation.

The DoD Components must submit their annual Statement of Assurance based on a general assessment of the effectiveness of their internal controls. The statement will be signed by the head of the Component and submitted to the Secretary of Defense each year.

Let's check the instructions generated by the MIC Program.



## Responsibility for Internal Control Plans (cont.)



**DoDI 5010.40 recommends that each Department component have an internal control plan that:**

- **Indicates what is to be evaluated**
- **Identifies what was accomplished**
- **Ensures results are consistent with your Statement of Assurance**

According to DoDI 5010.40, Managers' Internal Control (MIC) Program Procedures, an Internal Control Plan is a brief written plan, updated as necessary, that indicates the number of scheduled and accomplished internal control evaluations, the identity of DoD Component assessable units, and progress toward accomplishment of annual program requirements. The data contained in or summarized by the Internal Control Plan must be consistent with information reported in the DoD Component's Annual Statement of Assurance. The Internal Control Plan need not be lengthy. Any format may be used, as long as it addresses internal control evaluations throughout the organization and conveys, with a reasonable certainty, the knowledge that the internal control objectives have been accomplished.

In a nutshell, the Internal Control Plan should list what is to be evaluated, who evaluates, which type of evaluation is to be used, and what the schedule is for your evaluations. It summarizes the agency's risk assessment, planned actions, and internal control evaluations accomplished to provide reasonable assurance that your internal control program is in place and is effectively mitigating your risk.

Let's look at the regulation that gives rise to these instructions.



## Responsibility for Internal Control Plans (cont.)



### **Manager's role:**

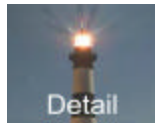
- **Office of Management and Budget (OMB) Circular A-123 outlines managers' responsibilities**
- **Take systematic and proactive measures**
- **Report annually on controls**
- **Follow up on audit recommendations**



According to Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Control, managers are responsible for the quality and timeliness of program performance, increasing productivity, controlling costs, mitigating adverse aspects of agency operations, and assuring that programs are managed with integrity and in compliance with applicable law.

Managers must take systematic and proactive measures to develop and implement appropriate, cost-effective internal control, assess the adequacy of internal control in their programs and operations, identify needed improvements, take corresponding corrective action, and report annually on those controls.

Let's take a look at some of these rules.

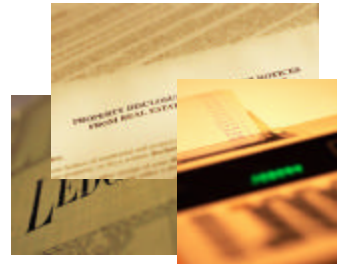


## Responsibility for Internal Control Plans (cont.)



**Management identifies obstacles and prepares corrective action plans in pursuit of an unqualified audit opinion. To this end, management must:**

- **Prepare corrective action plans**
- **Identify all known deficiencies**
- **Consider whether systemic problems exist**



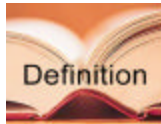
Your Internal Control Plan is used to correct deficiencies and plan solutions to produce accurate data. As managers, you must identify problem areas or deficiencies, then develop solutions to those problems. Problems may be identified from prior assessments or audits, analysis, tests of controls, or internal reviews of operations and procedures. They may include Department issues and systems issues affecting your subordinate organizations (your suballotees), or issues that are internal to your operation. Once problems are identified, you develop plans for corrective action.

These plans must include responsibility, milestones, and required resources. They should take into account the plans of your subordinate organizations and may depend on the plans of higher organizations or operations. You must monitor progress both within and outside of your organization to ensure that milestones are reached. Resources outside of your organization may be available to you, and solutions found by other organizations may be applicable to problems within your operation. Plans for corrective action may already be initiated on deficiencies found on previous audits and assessments, and new problems may be identified during their correction.

Your managers and staff should be encouraged to identify and report deficiencies, as this reflects positively on the agency's commitment to recognizing and addressing management problems. Failing to report a known deficiency would reflect adversely on the organization. You should carefully consider whether systemic problems exist that adversely affect internal controls across organizational or program lines. Management should prepare process flow diagrams that include internal control and system interfaces.

At this point of the Internal Control Plan you will identify in the plans, by financial statement line item, all known deficiencies relating to the item, including accounts requiring correction and processes requiring improvement. Let's learn more about what is involved in developing corrective action plans.





## Responsibility for Internal Control Plans (cont.)



### Developing Corrective Action Plans

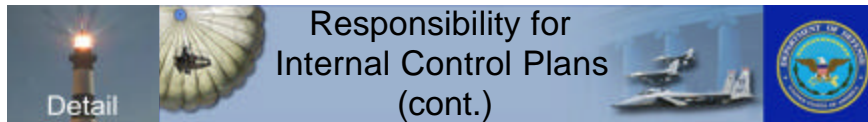
- **Identify material weaknesses**
- **Prepare corrective action plans**
- **Implement corrective action**
- **Incorporate effective oversight**



To prioritize corrective actions, managers should identify deficiencies that have a material impact on the financial statements. Management personnel then prepare comprehensive corrective action plans to resolve the identified deficiencies. Plans must identify how staff, processes, or business systems would be changed to implement corrective actions. Implemented plans must then incorporate effective oversight mechanisms to ensure that they are carried out and that the corrections are sustainable. Additionally, managers must base milestones on actual estimates of the effort required and identify critical task dependencies.

The corrective action plans should include any requirement for systems audits. Systems audits ensure that financial reporting systems are reliable. If current systems must be modified and the modifications are part of the corrective actions, management personnel must prepare a business case to support the modification and submit the case to the assigned OUSD(C) Point of Contact (POC).

Let's continue by exploring some areas where problems are found.



### **Sources of weakness:**

- **Audit/inspection reports**
- **Lessons learned**
- **Policy, procedure, and process reviews**
- **Hot-line reports**
- **Actual analysis**

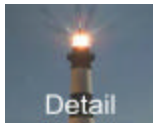


Problems are found on audit and inspection reports, from lessons learned in similar organizations, or from reviews of policies, procedures, and processes. They are also discovered through analysis of financial information, documentation, and systems. The establishment of a hot-line to report deficiencies such as those used to capture fraud, waste, and abuse information, without fear of reprisal, may also be a source for the identification of material weaknesses.

Similar entities may experience problems in areas that were not found on previous inspections or audits of your entity. Reviewing the findings of other entities may provide areas of needed improvement in your entity.

Management is responsible for reviewing policies, procedures, and processes to ensure that they are compliant with legal and regulatory guidance, and provide adequate control over entity resources. New procedures may be required in the absence of pre-existing procedural guidance, especially in areas of high personnel turnover, complicated processes, or high-value asset use.

Let's continue with these sources of weakness.



## Responsibility for Internal Control Plans (cont.)



### **Sources of weakness (cont.):**

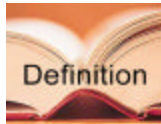
- **Analyze transactions and balances**
- **Trace transactions from origin to consolidation in financial statements**
- **Use available resources to perform systems analysis**

Analysis of financial information, documentation, and systems is used to identify unusual balances or entries, document trails and areas of inadequate documentation, and system controls. Unusual balances or entries may be the result of failure of a policy, procedure, or control, or of fraud.

Instances where complete documentation doesn't exist for tracing transactions from their origin to their consolidation into the financial statements must be identified. An analysis of the documentation required for transaction types assists in making this identification. Reversing the process traces a consolidated transaction to its origins. You must be able to trace your transactions all the way to the originating documents and be able to verify from those documents that amounts recorded on the financial statements are based on factual information, that adjustments made to that information are made using appropriate accounting practices, and that proper authorization exists at each level of the transaction.

Systems analysis may be accomplished using resources from outside of your entity. The Defense Information Systems Agency (DISA) is one source. Another is DFAS. Systems are analyzed to ensure that they are compatible with the future plans of the Department and that they apply adequate control for transaction authorization and separation of duties. They are also analyzed for their ability to provide meaningful financial information in a timely manner.

Let's look at the OMB requirements for implementing solutions to identified deficiencies.



## Responsibility for Internal Control Plans (cont.)



**OMB Circular A-123 requires Department entities to implement solutions within the milestone dates prescribed, resulting in a resolution of the identified deficiency.**

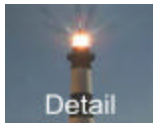
- **Identify any new deficiencies**
- **Modify plans to include any additions**
- **Requests for extension of dates should include a plan for getting back on track to meet the next original milestone date**



OMB Circular A-123 requires Department entities to implement solutions within the milestone dates prescribed, resulting in a resolution of the identified deficiency. Correction is a multi-faceted and incremental process. In other words, all corrective action steps are not expected to be completed on the same date. Management personnel and audit committees at each activity closely monitor progress to ensure that actions taken achieve the intended result in the time allotted.

As corrections are ongoing, it is anticipated that new deficiencies may be identified. As this occurs, activities coordinate with their OUSD(C) POC to modify plans to include any such additions. Requests for extension of dates should include actions taken to date, reason for date slippage, new proposed completion date, and a plan for getting back on track to meet the next original milestone date.

Let's consider these correction requirements.



## Responsibility for Internal Control Plans (cont.)



### **Correction requirements:**

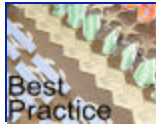
- **On time and incremental**
- **Resolve discrepancy**
- **Monitor progress and coordinate**
- **Extensions**

Corrective action plans must contain milestones and goals that are clearly measurable. Plans are incremental to allow for actions that may involve more than one entity. Management must assign tasks to responsible individuals in accordance with the corrective action plans and monitor progress. Individuals are held accountable for the accomplishment of their assigned tasks using a balanced scorecard approach.

As with many projects, problems may be encountered that require additional resources or time. Management may reassign resources or request assistance from outside sources. Identified problems may require action from other entities prior to correction of the original discrepancy. In such cases managers may reorganize actions that are not dependent upon the delayed processes to allow for the continuation of corrections.

As other entities may depend on the resolution of your original deficiency, it is important to coordinate with your OUSD(C) POC. Your POC works with you to identify resource requirements, coordinate schedules, and modify interim milestones. As mentioned earlier, you must have a plan for meeting the next original milestone.

Let's examine some best practices used by others.



## Responsibility for Internal Control Plans (cont.)



### **Best practices:**

- **Hold regular progress reviews**
- **Know your deficiencies**
- **Document responsibilities**
- **Partner with DFAS, DISA, and other service organizations**
- **Use available assistance**

Some suggestions of practices that have served well in similar organizations concerning discovery and correction are to have reviews regularly to check on how you are doing. As part of the monitoring process, reviews allow managers to identify resource requirements that may not have been anticipated in the corrective action plans. Reviews should have clear agendas and require responses from participants as to the status of their progress.

The best organizations know their deficiencies and assess their operations regularly. A recent practice, for example, within the Department is to brief mid-year and end-of-year financial statements to the DoD Comptroller. According to the GAO and the Department of Defense Office of the Inspector General (DoD OIG), the practice of preparing and explaining interim financial statements has improved the reliability of reported information through more timely discovery and correction of numerous recording and reporting errors. This can be applied to an Internal Control Plan, allowing for timely development of new controls to mitigate the deficiencies. Correction can only begin from a position of knowledge.

You must document responsibilities and ensure that you have clearly communicated who must perform the action, what must be done, when it must be completed, and the expected result of that action. Successful organizations do not attempt to solve problems outside of their areas of expertise. DFAS is an invaluable source of assistance. Its employees are familiar with audit requirements and have in fact passed more than one financial statement audit. DFAS employees are knowledgeable of financial reporting requirements, documentation requirements, financial systems and their capabilities, and internal control for financial management. DFAS employees may provide assistance in analysis of financial transactions and balances, and may be able to explain unusual transactions that affect your financial statements. Audit agencies may provide assistance with analysis and historical audit records for internal control.

Let's summarize what we've learned in this lesson.



## Lesson Summary

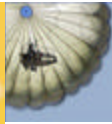


- **SOPs**
- **Flow Charts**
- **Audit Trails**
- **Responsibility for Internal Control Plans**

In this lesson, you learned about the documentation that supports an internal control program, including SOPs, flow charts, audit trails, and who is responsible for the Internal Control Plan. It reviewed how internal control SOPs provide you direction and guidance on responsibility, procedures, nomenclature, regulatory guidance, and examples of forms and reports.

In the segment on flow charts, you saw how flow charts play an important part in the assertion process and in analyzing your internal control program. The section on audit trails covered their requirements and examples of documents that are generated at various points in your processes. Finally, we covered who is responsible for your Internal Control Plan and how various phases in the business rules provide guidance in designing your control plan.

The following slides list references available for additional information.



## References



**SOP:** [https://eportal.dfas.mil/portal/server.pt/gateway/PTARGS\\_0\\_21992\\_203676\\_0\\_0\\_18/](https://eportal.dfas.mil/portal/server.pt/gateway/PTARGS_0_21992_203676_0_0_18/)

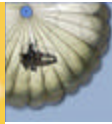
**PAR:** <http://www.defenselink.mil/comptroller/par/>

**GAO/PCIE Financial Audit Manual:**  
<http://www.gao.gov/special.pubs/gaopcie/>

**Fiscal Year 2002 National Defense Authorization Act,  
Section 1008**

**GAO Standards for Internal Control in the Federal  
Government:**  
<http://www.gao.gov/special.pubs/ai00021p.pdf>





## References (cont.)



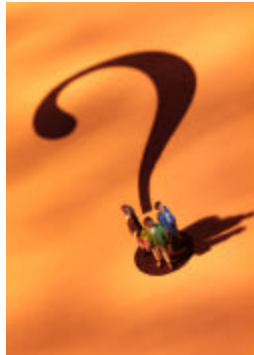
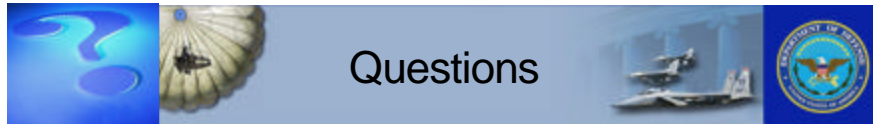
**NARA GRS:**

[http://www.archives.gov/records\\_management/records\\_schedules.html/](http://www.archives.gov/records_management/records_schedules.html/)

**DoDFMR:** <http://www.dod.mil/comptroller/fmr/>

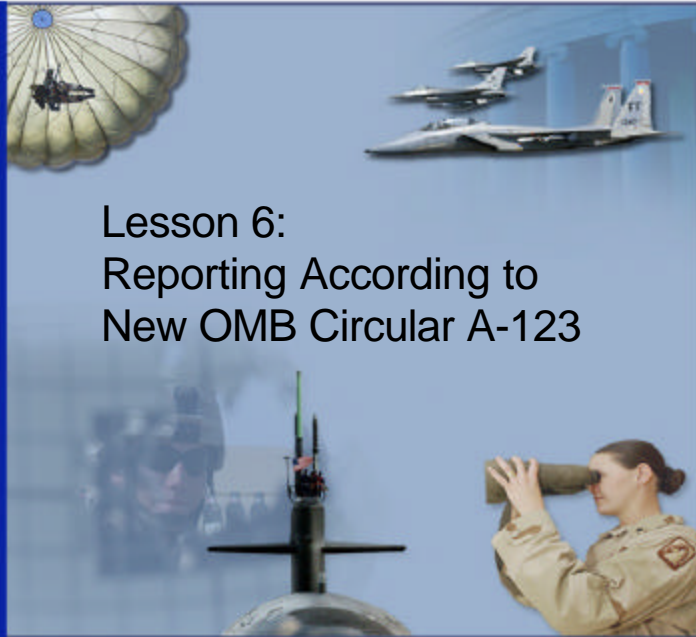
**OMB Circulars:**

<http://www.whitehouse.gov/omb/circulars/>



Before we move on to Lesson 6, Reporting According to New OMB Circular A-123, do you have any questions on the material covered in this lesson?

Effective  
Internal  
Control  
for Financial  
Reporting



Lesson 6:  
Reporting According to  
New OMB Circular A-123

In Lesson 6, we will describe how internal control is assessed, identify material weaknesses, and prepare the report. Finally, we will take a look at the Department's internal control reporting requirements based on the Office of Management and Budget (OMB) Circular A-123, 2004 Revision.

Let's discuss the objectives of this lesson.



## Lesson Objectives



**Upon successful completion of this lesson, you will be able to:**

- **Describe how to identify reportable conditions**
- **Identify material weaknesses**
- **Identify internal control reporting requirements**

This lesson explains how to recognize reportable conditions and identify material weaknesses. It also identifies internal control reporting requirements.

The importance of assessing the effectiveness of your organization's internal control program is reinforced by our review of the assessment process. The method by which you correct deficiencies in your internal control provides you and your auditor with assurance that the next iteration or design of a control addresses the shortcomings of the current control activity that oversees your operations or financial reporting.

As we have learned earlier, without documentation our internal control program would only be supposition. A look at internal control reporting requirements provides you with the format and content that support Department directives.



## Lesson Topics



**This lesson contains the following topics:**

- **Reportable Conditions**
- **Material Weaknesses**
- **Report Preparation**

In this lesson, we will examine how to identify reportable conditions. Next, we study the format for reporting internally within the Department.

We emphasize the Department's concern about whether or not internal control is in place and in fact addressing the deficiencies it is designed to mitigate. We will also identify and evaluate materiality with specific reference to some of the current weaknesses, to include Real Property, Military Equipment, Environmental Liabilities, and Fund Balance With Treasury (FBWT).

Let's turn our attention to correcting internal control deficiencies.



## Reportable Conditions



**“Take timely and effective action to correct deficiencies.”**



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Department managers are responsible for taking timely and effective action to correct internal control deficiencies, but all employees invariably provide the impetus to initiate the correction process. Deficiencies are identified based on scheduled assessments, ongoing monitoring, or daily awareness of whether or not the internal controls integral to operations and financial reporting are working.

Is the Standard Operating Procedure (SOP) being adhered to or supported? Does it cover all aspects of the operation? Are regulations and directives being followed? Oversight is good, but ownership of the internal control program is of paramount importance. After all, you are the stewards of our resources and only you can ascertain whether or not we are effectively and efficiently expending these finite resources.

Correcting deficiencies is an integral part of management accountability and must be considered a priority by your organization.

In order to correct a deficiency, recognition is paramount. Let's continue with a review of the identification of deficiencies.



## Reportable Conditions (cont.)



### Identification of Deficiencies

**Agency managers and employees should identify deficiencies in internal control from the sources of information described previously and the results of their assessment process.**

**Agency managers and employees should report control deficiencies to the next supervisory level, which will allow the chain of command structure to determine the relative importance of each deficiency.**

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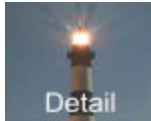
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Remember in Lesson 1 we defined a reportable condition as a deficiency that the agency head determines to be significant enough to be reported outside the agency and should be considered a material weakness and included in the annual Federal Manager's Financial Integrity Act (FMFIA) assurance statement and reported in the agency's annual Performance and Accountability Report (PAR). This designation requires a judgment by agency managers as to the relative risk and significance of reportable conditions.

Some of the deficiencies in internal control noted in daily operations can be corrected with a stroke of the pen by making a change to an SOP communicated via e-mail to all those concerned. These types of changes can be tracked on a scheduled basis with no formal organization. On the other hand, other internal control deficiencies may have a pervasive impact on operations and materially affect operations or financial reporting. In this case, corrective action plans must be developed and implemented, and then the progress realized should be periodically assessed and reported to management. It is incumbent on management to track the progress to ensure timely and effective results. For reportable conditions that are not included in the FMFIA report, corrective action plans should be developed and tracked internally at the appropriate level.

Let's continue with the correction process itself.



## Reportable Conditions (cont.)



**Management's process for resolution and corrective action of deficiencies must include:**

- **Identification of material weakness**
- **Appointment delegations**
- **Promptness**
- **Records**

In identifying and assessing the relative importance of reportable conditions, consideration should be given to the views of the agency's Inspector General (IG). The significant deficiencies identified under Financial Information Security Management Act (FISMA) must be reported as material weaknesses in the annual FMFIA report. Agency managers and staff should be encouraged to identify control deficiencies, as this reflects positively on the agency's commitment to recognizing and addressing management problems. Failing to report a known reportable condition would reflect adversely on the agency and continue to place the agency's operations at risk. Agencies should carefully consider whether systemic weaknesses exist that adversely affect internal control across organizational or program lines.

A summary of the corrective action plans for material weaknesses must be included in the agency's PAR. We have seen examples of weaknesses and the milestones that the Department has set addressing deficiencies. The summary must include a description of the material weakness, status of the corrective actions, and schedule for resolving the deficiency.

Management's process for correcting material weaknesses in internal control must provide for appointment of a correction action official reporting to the Senior Management Council if required. The process also requires prompt resolution and corrective action while maintaining accurate records on the status during the entire process.

Let's continue with evaluating lines for materiality.





## Material Weaknesses



The following provides criteria to assist in evaluating lines for materiality:

- **Significantly impairs fulfillment of mission**
- **Significantly weakens safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets**
- **Violates a statutory requirement**
- **Allows fraud to go undetected**
- **Deprives the public or the Component of needed government services**
- **Causes significant adverse publicity for the Department of Defense (DoD)**

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A deficiency may be deemed to be material if it: significantly impairs fulfillment of mission; significantly weakens safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; violates a statutory requirement; allows fraud to go undetected; deprives the public or the Component of needed government services; or causes significant adverse publicity for the Department of Defense (DoD).

It should be reported if it is or should be of interest to the next level of management. Employees and managers should report deficiencies to the next supervisory level, which allows the chain of command structure to determine the relative importance of each deficiency. A deficiency that is determined to be significant enough to report outside the agency is considered a “material weakness.”

Let's continue with additional materiality criteria.



## Material Weaknesses (cont.)



**The following provides criteria to assist in evaluating lines for materiality (cont.):**

- **Results in a conflict of interest**
- **Involves significant adverse impact on information security**
- **Generates unreliable information causing unsound management decisions**
- **Results in potential or actual injury or death of an employee**

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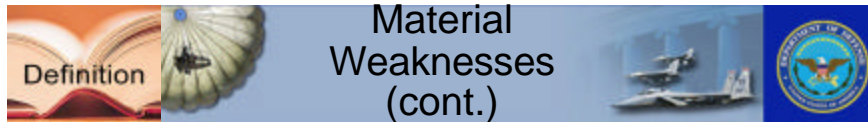
L6-8

This criteria can have both quantitative and qualitative impacts upon materiality. Even though quantitatively immaterial, certain types of misstatements could have a material impact on or warrant disclosure in the financial statements for qualitative reasons. For example, intentional misstatements or omissions (irregularities) usually are more critical to the financial statement users than are unintentional errors of equal amounts. This is because the users generally consider an intentional misstatement more serious than clerical errors of the same amount.

The Government Auditing Standards Yellow Book states that materiality is a matter of professional judgment influenced by the needs of the reasonable person relying on the financial statements such as the public accountability of the auditee and the visibility and sensitivity of government programs, activities, and functions.

Financial misstatements cannot only impact budgets but can directly affect operations by not having the required supplies available pursuant to operations. Without supplies, Soldiers, Sailors, Airmen, and Marines may be more concerned with mission survival than mission completion.

Let's look at types of material weaknesses and how the Department addresses them.



## FMFIA Types of Weakness – as reported in the DoD Performance and Accountability Report (PAR)

1. **Section 2 Systemic Weaknesses:**  
Weaknesses materially affecting management controls across organizational and program lines and usually affecting multiple DoD components.
2. **Section 2 Material Weaknesses:**  
Weaknesses materially affecting management controls that warrant reporting to a higher level and usually affect a single DoD component.
3. **Section 4 System Nonconformance Weaknesses:** System nonconformance with the principles, standards or related requirements prescribed by the Comptroller General.

**[http://www.defenselink.mil/comptroller/par/fy2004/01-01\\_MD\\_and\\_A.pdf](http://www.defenselink.mil/comptroller/par/fy2004/01-01_MD_and_A.pdf)**

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The Department reports three types of FMFIA weaknesses: systemic weaknesses, which are more pervasive problems that usually affect more than one DoD Component or cross organizational lines; material weaknesses, which usually affect only one DoD Component; and system nonconformance weaknesses which are problems affecting the ability of systems to report financial information in accordance with applicable standards.

The Department began Fiscal Year (FY) 2004 with 17 financial weaknesses, five of which were systemic and 12 were material. During the year, the Department corrected five relating to financial issues and reported five as new material weaknesses, ending the year with a total of 17. The Department identified nine areas that affect numerous DoD Components as systemic weaknesses.

In fiscal years 2002, 2003, and 2004, the Department reported one Section 4 System Nonconformance Weakness which encompasses the entire Department. It concerned financial system noncompliance with control requirements.

In addition, the auditors have identified 11 material weaknesses under the requirements of the Chief Financial Officers (CFO) Act. Among them is the DoD FISMA in fiscal years 2002, 2003, and 2004 and the ones that are emphasized in this course, Environmental Liabilities, Fund Balance With Treasury, Real Property, and Military Equipment.

The Department strongly encourages forthright reporting of material weaknesses in internal controls for all programs and operations important to the Department's mission.

Let's look at an example of one systemic weakness.



## Material Weaknesses (cont.)



### FMFIA Systemic Weakness

Title	Description of Issue	Progress to Date
DoD Financial Management Systems and Processes	The DoD financial and business management systems and processes are costly to maintain and operate, are not fully integrated, and do not provide information that is reliable, timely, and accurate.	Completed Milestones: <ul style="list-style-type: none"><li>• Created a portfolio management approach to review information technology investments.</li><li>• Incorporated the Enterprise Business Process Model into the Business Enterprise Architecture Release 2.1.</li><li>• Established integrated goals, objectives, measures, and targets.</li><li>• Initiated a single Department-wide information technology registry to track all business systems.</li></ul>

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The systemic weakness describes a problem concerning the Department's financial and business management systems and processes. It states that they are costly to maintain and operate, are not fully integrated, and do not provide information that is reliable, timely, and accurate. To help resolve this problem, the Department has taken some aggressive action.

In FY 2004, the Department took numerous steps to improve the Department-wide training, awareness, communication, and emphasis for full disclosure and prompt resolution of weaknesses. Beginning at mid-year in FY 2004, the Department began using an automated system to track and update the progress of corrective actions for reported weaknesses.

The Department has many actions left to complete, so let's consider the Planned Milestones for FY 2005.



## Material Weaknesses (cont.)



### FMFIA Systemic Weakness (cont.)

Title	Description of Issue	Progress to Date
DoD Financial Management Systems and Processes	The DoD financial and business management systems and processes are costly to maintain and operate, are not fully integrated, and do not provide information that is reliable, timely, and accurate.	Planned Milestones for FY 2005: <ul style="list-style-type: none"><li>• Complete the Business Enterprise Architecture (BEA) Increment #1, which includes business processes in support of an unqualified audit opinion.</li><li>• Perform targeted portfolio management reviews as part of the FY 2005 through FY 2006 planning, programming, and budgeting process.</li></ul>

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This slide shows the planned milestones for FY 2005 corrective actions for financial management systems.

Quarterly tracking has increased leadership's awareness of the importance the Department places on prompt resolution of reported weaknesses. A Management Control Program scorecard was also implemented to score the critical elements of Statement of Assurance (SOA) reporting: timeliness, format, program execution, training, and material weakness reporting.

This systemic weakness involves several financial reporting systems and may have an effect on multiple lines in the financial statements. Let's look at a few financial statement line items and discuss the evaluation of these lines for materiality.



## Material Weaknesses (cont.)



### CFO Act Material Weakness: Military Equipment

General Property, Plant and Equipment (PP&E)	The cost and depreciation of DoD General PP&E is not reliably reported due to: (a) a new accounting requirement that went into effect in FY 2003 that classifies military equipment as General PP&E (such costs were previously expensed), (b) a lack of supporting documentation for General PP&E which were purchased many years ago, and (c) most legacy property and logistics systems are not integrated with acquisition and financial systems and were not designed to capture the acquisition cost, cost of modifications and upgrades, or calculate depreciation.	The Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department plans to complete valuations of all known military equipment programs by September 2005. The military equipment baseline will be updated to a single base year in fiscal year 2006. The Department plans to develop a white paper on accounting and reporting for spare parts, based on the practices of other Federal agencies and private sector organizations. The paper will be submitted to the Federal Accounting Standards Advisory Board, with resolution anticipated by March 2005.
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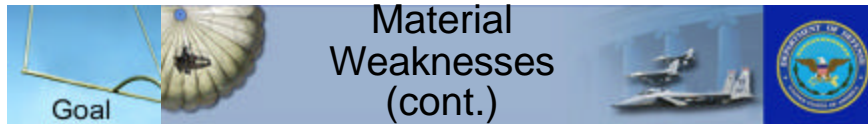
L6-12

Notice that this auditor-identified weakness involves the reporting of General Property, Plant, and Equipment (PP&E). It describes the change in classification of Military Equipment, talks about the lack of supporting documentation, and addresses system s integration issues. In response, the Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department plans to complete valuations of all known Military Equipment programs by September 2005, and update the Military Equipment baseline to a single base year in FY 2006.

The Department also plans to develop a white paper on accounting and reporting for spare parts, based on the practices of other Federal agencies and private sector organizations. The paper will be submitted to the Federal Accounting Standards Board (FASAB), with resolution anticipated by March 2005.

Planned Milestones for FY 2005 are to initiate common reporting of facility conditions. Another milestone is to set new corporate demolition and disposal targets for removing obsolete and excess assets from the inventories. The last milestone is to release a Real Property requirements model that addresses requirements for facility related services, utilities, and leasing.

The target correction date is 1st Quarter, FY 2008. Let's look at the planned milestones for beyond 2005.



### **Planned Milestones Beyond FY 2005**

- **Complete the establishment of baseline**
- **Ensure that the Military Departments assert that Military Equipment ending balances are ready for audit**
- **Ensure that the Military Department Audit Services complete their reviews and inform the DoD Office of Inspector General (OIG) that Military Departments are ready for financial statement audits**
- **Ensure that the audit community completes the audits and the Department receives an unqualified audit opinion**

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There are four milestones planned beyond FY 2005. The first milestone is to complete the establishment of baseline values for Military Equipment. The second milestone is to ensure that the Military Departments assert that PP&E ending balances are ready for audit. The third milestone is to ensure that the Military Department Audit Services complete their reviews and inform the DoD Office of Inspector General (OIG) that Military Departments are ready for financial statement audits. The fourth milestone is to ensure that the audit community completes the audits and the Department receives an unqualified audit opinion.

The target date for correction is 4th Quarter, FY 2006.

Let's look at the General PP&E weakness as described in the 2004 PAR and the plans to correct it.





## Material Weaknesses (cont.)



### CFO Act Material Weakness: General PP&E

General Property, Plant and Equipment (PP&E)	The cost and depreciation of DoD General PP&E is not reliably reported due to: (a) a new accounting requirement that went into effect in FY 2003 that classifies military equipment as General PP&E (such costs were previously expensed), (b) a lack of supporting documentation for General PP&E which were purchased many years ago, and (c) most legacy property and logistics systems are not integrated with acquisition and financial systems and were not designed to capture the acquisition cost, cost of modifications and upgrades, or calculate depreciation.	The Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department plans to complete valuations of all known military equipment programs by September 2005. The military equipment baseline will be updated to a single base year in fiscal year 2006. The Department plans to develop a white paper on accounting and reporting for spare parts, based on the practices of other Federal agencies and private sector organizations. The paper will be submitted to the Federal Accounting Standards Advisory Board, with resolution anticipated by March 2005.
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This auditor-identified weakness states that the cost and depreciation of DoD General PP&E is not reliably reported due to:

- (a) A new accounting requirement that went into effect in FY 2003 that classifies Military Equipment as General PP&E (such costs were previously expensed).
- (b) A lack of supporting documentation for General PP&E which were purchased many years ago. Is your audit trail supported by easily accessible documents?
- (c) Most legacy property and logistics systems are not integrated with acquisition and financial systems and were not designed to capture the acquisition cost, cost of modifications and upgrades, or calculate depreciation.

Let's continue with the FMFIA -initiated milestones that the Department acted upon as part of its corrective action plan.





## Material Weaknesses (cont.)



### CFO Act Material Weakness: General PP&E (cont.)

General Property, Plant and Equipment (PP&E)	The cost and depreciation of DoD General PP&E is not reliably reported due to: (a) a new accounting requirement that went into effect in FY 2003 that classifies military equipment as General PP&E (such costs were previously expensed), (b) a lack of supporting documentation for General PP&E which were purchased many years ago, and (c) most legacy property and logistics systems are not integrated with acquisition and financial systems and were not designed to capture the acquisition cost, cost of modifications and upgrades, or calculate depreciation.	The Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department plans to complete valuations of all known military equipment programs by September 2005. The military equipment baseline will be updated to a single base year in fiscal year 2006. The Department plans to develop a white paper on accounting and reporting for spare parts, based on the practices of other Federal agencies and private sector organizations. The paper will be submitted to the Federal Accounting Standards Advisory Board, with resolution anticipated by March 2005.
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The Department, having recognized this auditor-identified weakness, also reported it as a FMFIA material weakness, and completed the following milestones for FY 2004:

- Established offices and groups of personnel to develop baseline valuations for PP&E
- Received financial improvement and executing plans from Components
- Established recurring reviews of DoD Components' progress against plans
- Established metrics
- Issued new guidance for Internal Use Software Financial Management Policy
- Directed the Defense Commissary Agency (DeCA) and the Military Services to reconcile property under the Department's preponderance of use policy. The Department has begun a similar initiative with the other Defense Agencies.

Now let's discuss our next material line, Environmental Liabilities.



## Material Weaknesses (cont.)



### CFO Act Material Weakness: Environmental Liabilities

Environmental Liabilities	Guidance and audit trails are insufficient. The inventory of ranges and operational activities (landfills, open burning pits, etc.) is incomplete.	The Department issued guidance for closed sites in October 2002 and continues to issue guidance for ongoing operations. Inventories of operational and non-operational ranges are complete. Additional review and validation is needed to ensure audit trails are sufficient.
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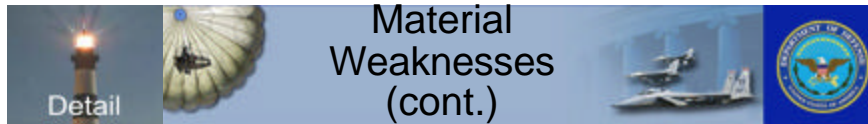
According to the 2004 PAR, a material weakness was both reported as a FMFIA management-reported and a CFO Act auditor-reported weakness concerning the sufficiency of guidance and audit trails for Environmental Liabilities. The PAR also reports that inventory of ranges and operational activities (such as landfills or open burning pits) is incomplete.

To correct these deficiencies, the Department issued guidance for closed sites in October 2002 and continues to issue guidance for ongoing operations. Inventories of operational and non-operational ranges are complete, and additional review and validation is needed to ensure audit trails are sufficient. Completed internal control milestones include:

- Provided guidance to accomplish an initial operational range inventory.
- Reported the operational range inventory to Congress in February of FY 2004.
- Completed a Real Property inventory business process reengineering and presented the concept for DoD-wide review.
- Revised the DoD Financial Management Regulation (FMR) for liability recognition and reporting for operational ranges and munitions response areas.
- Published the directive entitled "Sustainment of Ranges and Operating Areas," that requires reporting of environmental remediation liabilities.
- Issued planning guidance that requires the assessment of environmental condition of the operational ranges.

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, better site characterization with sampling, and re-estimation based on different assumptions, lessons learned, and advances in technology. Future changes may be attributed to changes in laws and regulations, and changes in agreements with regulatory agencies. We have to keep apprised of an evolving situation in order to be current with our recognition and evaluation of our Environmental Liabilities.

Let's finish this topic with management's process for resolution and corrective actions of these deficiencies.



**Management's process for resolution and corrective action of deficiencies must include:**

- **Plans**
- **Appraisals**
- **Reports**

Management must internally maintain detailed corrective action plans that are available for OMB review. The management resolution and corrective action process must ensure that the corrective action plans are consistent with laws, regulations, and administrative policy. This process must also ensure that performance appraisals of appropriate officials reflect effectiveness in resolving or implementing corrective action for identified material weakness.

You are only to report that a reportable condition has been corrected when you have the evidentiary matter (results and reports) supporting the resolution of the deficiency in the internal control. A fix to a material weakness in an internal control will require extensive documentation and corroboration. It takes time to monitor the results of a correction. There are incremental adjustments made to ensure that you stay on course.

Management must make a decision regarding IG audit recommendations within a six-month period after issuance of the audit report and then implement the changes to internal control within one year, to the extent practicable. Resolution and corrective actions must be in writing with supporting documentation available for review by appropriate officials.

Finally, let's examine what internal control reporting is required internally by OMB.



## Report Preparation



**Reporting is required according to the OMB Circular A-123, Management's Responsibility for Internal Control. Recent government-wide initiatives have been implemented to:**

- **Improve program and financial management**
- **Accelerate reporting**
- **Assess the effectiveness and efficiency of program operations**

OMB Circular A-123, Management's Responsibility for Internal Control, requires the reporting by management of its internal control program.

Internal control includes the organization, methods, and procedures adopted by management to meet its goals. It includes processes for planning, organizing, directing, controlling, and reporting on agency operations. Recent government-wide initiatives have been implemented to improve program and financial management, including tracking corrective actions for material weaknesses, imposing accelerated reporting due dates for more timely financial information, and assessing the effectiveness and efficiency of program operations.

According to OMB Circular A-123, management must annually provide assurances on internal control in its PAR, including a separate assurance on internal control over financial reporting, along with a report on identified material weaknesses and corrective actions.

The annual assurance statements and associated materials and systemic weaknesses required by Section 2 and Section 4 of the FMFIA and further defined by OMB Circular A-123 including Appendix A, are provided in a single FMFIA report section of the annual PAR labeled Management Assurances. This section includes the annual assurance statements, summary of material weaknesses and non-conformances, and summary of corrective action plans. Management's assurance statement relating to internal control over financial reporting and any related material weaknesses and corrective actions is separately identified.

OMB Circular A-123 consolidates many of these reporting requirements. Let's look at one best practice in reporting.



## Report Preparation (cont.)



### **Best practices for reporting:**

- **Report information consistently**
  - **In accordance with OMB Circular A-123, Management's Responsibility for Internal Control**
  - **In accordance with OMB Circular A-127, Financial Management Systems**
- **Make reporting an on-going process, not just annually**
- **Continuously monitor and improve internal control**

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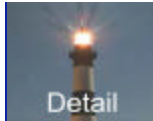
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To ensure that applicable information is available on whether the agency's controls are achieving their intended objectives on material weaknesses in the agency's controls, and on whether the agency's financial management systems conform with government-wide requirements, you must report information consistently in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. This pertains specifically to Section 2 of the FMFIA, and OMB Circular A-127, Financial Management Systems, which incorporates Section 4 of the FMFIA.

You must make financial management an ongoing process, not just an annual requirement. Agency managers who continuously monitor and improve the effectiveness of internal control associated with their programs have established the foundation that provides the basis for the agency head's annual assessment of and report on internal control.

Let's take a look at the detail of the revised OMB Circular A-123's Statement of Assurance.



## Report Preparation (cont.)



### **Reporting on internal control and internal control over financial reporting:**

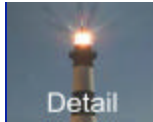
- **Statement of Assurance**
- **Summary of material weaknesses and non-conformances**
- **Summary of corrective action plan**

The annual Statements of Assurance on internal control (operational and financial) must be submitted to the Secretary of Defense by September 1 of each year. Management asserts to the effectiveness of internal control on financial reporting as of June 30, and the statement should include a cover memorandum providing the agency head's informed judgment as to the overall adequacy and effectiveness of internal control within the agency.

The statement must include either an unqualified Statement of Assurance (no material weaknesses reported), a qualified Statement of Assurance considering the exceptions explicitly noted (one or more material weaknesses reported), or a Statement of no Assurance (no processes in place or pervasive material weaknesses). The statement should also include a summary of material weaknesses and non-conformances, and a summary of corrective action plans.

The Statement of Assurance for internal control over financial reporting is a change to the OMB Circular A-123 and requires management to provide a separate assurance. The assurance is a subset of the overall Statement of Assurance and is based on management's assessment conducted in accordance with OMB Circular A-123, Appendix A, Internal Control over Financial Reporting.

Let's continue with the internal reporting requirements.



## Report Preparation (cont.)



### Internal reporting requirements:

- **Control deficiencies**
- **Reportable conditions**

Control deficiencies exist when the design or operation of a control does not allow management or employees, in normal course of their assigned functions, to prevent or detect misstatements on a timely basis. A design deficiency exists when a control necessary to meet the control objective is missing or an existing control is not properly designed. Even if the control operates as designed, the control objective is not always met. An operational deficiency exists when a properly designed control does not operate as designed or when the person performing the control is not qualified or properly skilled to perform the control effectively.

Reportable conditions (FMFIA Section 2) for FMFIA overall are control deficiencies (or combination thereof) that in management's judgment, should be communicated because they represent significant weaknesses in the design and operation of internal control that could adversely affect the agency's ability to meet its internal control objectives.

For financial reporting, it is a control deficiency that adversely affects the entity's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with Generally Accepted Accounting Principles (GAAP) such that there is more than a remote likelihood that a serious misstatement of the entity's financial reports will not be prevented or detected. Each deficiency is reported internally with progress on the corrective action plans should be periodically assessed and reported to agency management.

Let's continue with the DoD Directive 5010.30 requirements for the Statement of Assurance Over Internal Control.



## Report Preparation (cont.)



### **The Statement of Assurance Over Internal Control covers:**

- **Rules and regulations that drive the Statement of Assurance**
- **Types of internal control**
- **Financial reporting internal control**

DoD Components are required by DoD Directive (DoDD) 5010.38, Managers' Internal Control (MIC) Program, to submit an annual statement of assurance based on a general assessment of the effectiveness of their internal control. This statement also includes identified material weaknesses and a plan to correct them that is consistent with annual Office of the Under Secretary of Defense, Comptroller (OUSD(C)) guidance about the content and structure of the statement.

The statement must be signed by the head of the Component or the principal deputy and submitted to the Secretary of Defense by September 1<sup>st</sup> of each year. An alternative date may be substituted if it is required by the annual guidance.

In discussing the SOA, it is imperative to follow the guidelines and requirements of DoDD 5010.38, MIC Program, DoD Instruction (DoDI) 5010.40, Managers' Internal Control Program Procedures, and the MIC Program annual guidance.

Let's see what was stated in the Statement of Assurance Over Internal Control for FY 2004.





## Report Preparation (cont.)



### Statement of Assurance

#### Message from the Deputy Secretary of Defense

November 15, 2004

I am pleased to present the Department of Defense fiscal year 2004 Performance and Accountability Report.

The Department has made significant progress in transforming America's defense posture to enable decisive plans to address future security challenges. We have demonstrated our superior warfighting capabilities in Iraq and Afghanistan. The price of democracy is not cheap. We see continual pressures on the Department's resources in the years ahead. We will focus relentlessly on efficient and careful use of these resources as we continue fighting the global war on terror.

The Department has made improvements in its personnel management practices and we will continue to drive towards a performance-based rating of our workforce. The quality of life of our military members, who risk their lives for all of us to enjoy the freedoms of democracy, has been enhanced by upgrading facilities and advancing private-public partnerships in military housing. We have also seen efficiencies due to practicing performance-based budgeting, increasing our focus on core support functions, and reforming our annual review of programs and funding.

Although the Department received a disclaimer of opinion on its financial statements, there have been advancements throughout the past year in the Department's efforts to improve financial reporting and management processes. Specifically, through the Department's Business Management Modernization Program, the financial management processes and controls are being integrated into the business processes to ensure accountability and auditability of the Department's business transactions.

The Department now has a report card that identifies how well we did in achieving the strategic plan, objectives, and goals. This is an effective management tool that is allowing us to fine-tune our implementation of the strategic plan. Looking at our report card results this year, the Department met several of its performance goals, but still has work to do in other areas. The report displays all of the Department's performance results this year and provides a clear picture of our progress in meeting our objectives.

The Department is committed to effective internal controls, full compliance with established guidelines and standards, and proper stewardship of the resources entrusted to it. During fiscal year 2004, we corrected 11 management control weaknesses, and except for the unresolved weaknesses noted in the Management Discussion and Analysis section of this report, the Department has reasonable assurance that its management controls are effective. The Department will continue its efforts to resolve the remaining issues and I am confident that the Department will continue to fulfill its mission responsibilities.

Looking ahead, the Department continues the transformation of its support structure and management practices. While the Department has made progress in many areas, we must continue to upgrade performance and accountability, streamline and strengthen management, and ensure that every defense dollar is expended as wisely as possible.

  
Paul Wolfowitz

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Here is where each entity's statement of assurance comes to fruition, the statement from the Deputy Secretary of Defense. The state of affairs for FY 04 on internal control is summed up as:

"The Department is committed to effective internal controls, full compliance with established guidelines and standards, and proper stewardship of the resources entrusted to it. During FY 2004, we corrected 11 management control weaknesses, and except for the unresolved weaknesses noted in the Management Discussion and Analysis section of this report, the Department has reasonable assurance that its management controls are effective. The Department will continue its efforts to resolve the remaining issues and I am confident that the Department will continue to fulfill its mission responsibilities."

The criteria for all requirements for the Statement of Assurance is found in DoDD 5010.38, Managers' Internal Control (MIC) Program, DoDI 5010.40, MIC Program Procedures, and the MIC Program Annual Guidance.

Let's summarize what we've learned in this lesson.



## Lesson Summary



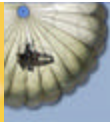
- **Reportable Conditions**
- **Material Weaknesses**
- **Report Preparation**

In this lesson, you learned what are reportable conditions and that if the conditions are realized in your business unit, you must take timely and effective action to correct the deficiencies. You identified and evaluated materiality with specific reference to some of the current weaknesses, to include Real Property, Military Equipment, Environmental Liabilities, and FBWT.

Next, we examined the methodology for correcting internal control deficiencies (material or not) and then studied the format for reporting internally within the Department, covering the both operational and financial reporting deficiencies.

In discussing reporting, you learned that annually, management must provide assurances on internal control in its PAR, including a separate assurance on internal control over financial reporting, along with a report on identified material weaknesses and corrective actions.

The following slides list references available for additional information.



## References



**Government Accountability Office (GAO)/President's Council on Integrity and Efficiency (PCIE) Financial Audit Manual (FAM):**

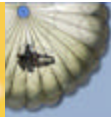
**<http://www.gao.gov/special.pubs/gaopcie/>**

**GAO Standards for Internal Control in the Federal Government:**

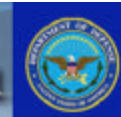
**<http://www.gao.gov/special.pubs/ai00021p.pdf>**

**Checklist for Reviewing Systems under the FFMIA:**

**<http://www.gao.gov/new.items/d05225g.pdf>**



## References (cont.)



### **OMB Circulars:**

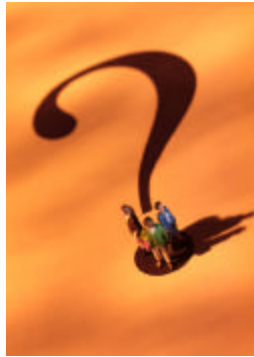
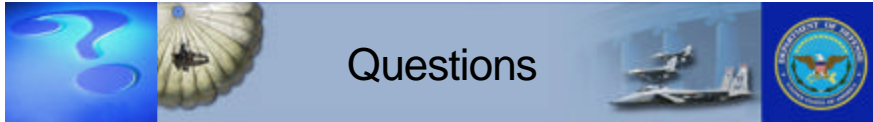
**<http://www.whitehouse.gov/omb/circulars/>**

### **PAR:**

**[http://www.defenselink.mil/comptroller/par/fy2004/01-01\\_MD\\_and\\_A.pdf](http://www.defenselink.mil/comptroller/par/fy2004/01-01_MD_and_A.pdf)**

### **Single Audit:**

**<http://www.dodig.mil/Inspections/APO/SingleAudit/MAIN.html>**



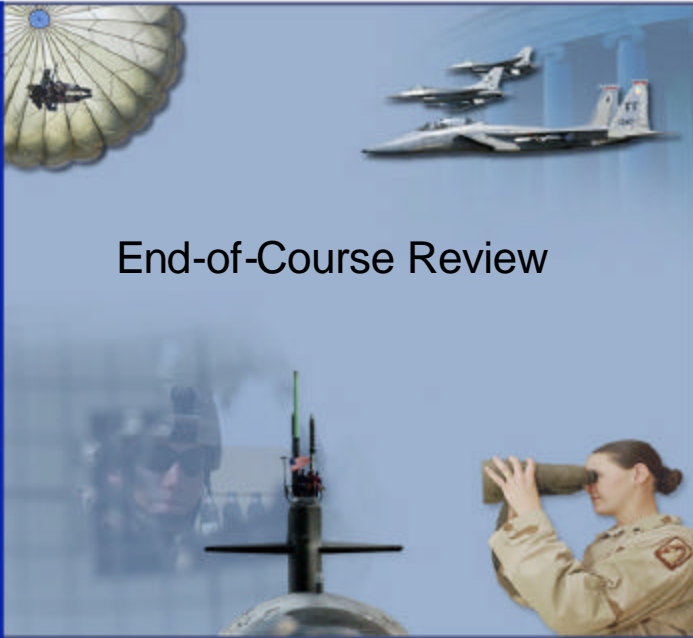
Before we move on to the End-of-Course Review, do you have any questions on the material covered in this lesson?

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## Effective Internal Control for Financial Reporting



## End-of-Course Review



Let's review the course objectives that we discussed today in this course. This course was designed to help you understand the internal control environment and how risk drives the development and maintenance of an internal control program.

In this course you learned the types of internal control and their importance in effectively managing resources and the relationship of internal control and risk to financial reporting. You learned the Government Accountability Office (GAO) and Office of Management and Budget (OMB) requirements and standards based in law that require management to establish effective and cost efficient internal control. You explored process flows and how analysis of a process allows you to realize your internal control requirements.

You also identified and evaluated materiality with specific reference to some of the current financial statement weaknesses. You learned that risk impacts your operations and financial reporting to the effect that it can result in a less than unqualified audit opinion.

You examined risk analysis and how it defines which internal control best fits your organization's operations and financial reporting. We discussed Internal control assessments and whether the internal control program in place is designed to address the risk associated material lines. You learned why it is necessary to document internal control processes. Finally, you described how to correct internal control deficiencies, recognize material weaknesses, and report on those conditions by adhering to the Department's internal control reporting requirements based on the revised OMB Circular A-123.

Let's review the information presented in the lessons.



## End-of-Course Review



### **Lesson 1, Internal Control**

- **Internal Control Overview**
- **Management's Responsibility**
- **Keys to Developing Valuable Internal Control**
- **Types of Internal Control**
- **Importance of Internal Control**
- **Relationship of Internal Control and Risk to Financial Reporting**
- **FMFIA and OMB Requirements**
- **GAO and OMB Standards**

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In Lesson 1, you learned about the internal control process and how an effective and efficient internal control system serves as a basis for an organization to achieve an unqualified assurance. Management responsibility does not just come from the top, but valuable input comes from the field to gauge how well internal control works and whether it addresses those issues that they were designed to affect.

Remember, internal control is defined by the revised OMB Circular A-123, as “the tools (organization, policies, and procedures) to help program and financial managers achieve results and safeguard the integrity of their programs.” Internal control should be an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing. It should support the effectiveness and the integrity of every step of the process and provide continual feedback to management. At each step of a business process, we learned that internal control, in the shape of a directive or SOP ensures that you are expending your resources in an expeditious, effective, and efficient manner.

After covering the descriptions, definitions, and types of internal control, we finally discussed its importance, from accountability to safeguarding assets, and the requirements and standards that provide the legal basis for internal control reporting.

Let's review Lesson 2, Identifying Processes and Transactions.





## End-of-Course Review (cont.)



### **Lesson 2, Identifying Processes and Transactions**

- **Evaluating Lines for Materiality**
- **Process Flows to Document Business Processes (with some examples using):**
  - **Military Equipment**
  - **Real Property**
  - **Environmental Liabilities**
  - **Fund Balance With Treasury**

In Lesson 2, you learned about process flows and how the analysis of a process will allow you to realize your internal control requirements.

You also discovered how to identify and evaluate materiality with specific reference to some of the current material weaknesses recognized in the DoD's financial statement, including Real Property, Military Equipment, Environmental Liabilities, and Fund Balance with Treasury (FBWT).

Analysis is important because without the ability to identify and break down your business processes, you would be unable to effectively employ internal control to mitigate the risks associated with your daily business practices. You discovered that the ability to recognize the materiality of lines and accounts on your financial statements, and significant accounts, provides the ending and starting point for you to identify the documents that make up an audit trail, allowing you to find the root cause of a material weakness.

Let's review Lesson 3, Determining Risks.



## End-of-Course Review (cont.)



### **Lesson 3, Analyzing Risks**

- **Risk as Associated with Materiality**
- **Analysis of Risk**
- **Existence or Occurrence**
- **Completeness**
- **Rights and Obligations**
- **Valuation or Allocation**
- **Presentation and Disclosure**

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In Lesson 3, you learned about materiality and its relationship to risk with the view that each Component, agency, and unit have differing perspectives on what is or isn't material to their operations. We covered how risk analysis is important to you as the proper identification and analysis of risk provides your organization with the basis to design and implement an internal control program to mitigate the risks identified.

You looked at the assertions tested by auditors to give you a perspective on the assertion process itself. Finally, the testing of internal control which provides your auditor the basis for assessing whether or not the organization is in fact ready for an audit was covered.

You learned that materiality is one of several tools the auditor uses to determine that the planned nature, timing, and extent of procedures are appropriate. As defined in Financial Accounting Standards Board (FASB) Statement of Financial Concepts No. 2., materiality represents the magnitude of an omission or misstatement of an item in a financial report that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item.

The level of risk invariably provides the basis for consideration of materiality. In turn materiality dictates what is to be asserted. Your internal control program must be efficient and effective enough to substantiate your assertions. Let's review Lesson 4, Assessing Internal Control.



## End-of-Course Review (cont.)



### **Lesson 4, Assessing Internal Control**

- **Internal Control Assessment**

In Lesson 4, you learned about how to evaluate internal control in your organization through an internal control assessment process. By having a team drive the internal control assessment process, you can be reasonably assured that you are providing reliable information to your customer, the Department, and your auditor.

You realized the value of the internal control assessment process because it establishes the controls you have in place, assuring that your operations and reporting are being effectively and efficiently executed. The internal control assessment process corroborates your assertions in your statement of assurance. If there are deficiencies, you will be able to target the deficiencies and have a plan in place to present to your auditors, assuring them that your internal control management is effective.

Let's review Lesson 5, Documenting Internal Control Processes.



## End-of-Course Review (cont.)



### **Lesson 5, Documenting Internal Control Processes**

- **Standard Operating Procedures (SOPs)**
- **Flow Charts**
- **Audit Trails**
- **Responsibility for Internal Control Plans**

In Lesson 5, you learned about the documentation that supports an internal control program, including Standard Operating Procedures (SOPs), flow charts, and audit trails. You also learned who is responsible for the internal control plan. This lesson showed you how internal control SOPs provide direction and guidance on responsibility, procedures, nomenclature, regulatory guidance, forms, and reports.

In the segment on flow charts, you saw how flow charts play an important part in the assertion process and in analyzing your internal control program. We discussed audit trails, their requirements, and examples of documents that are generated at various points in time. Finally, this lesson covered who is responsible for your internal control plan and how various phases in the business rules provide guidance in designing your control plan.

Let's review Lesson 6, Reporting According to New OMB Circular A-123.



## End-of-Course Review (cont.)



### **Lesson 6, Reporting According to New OMB Circular A-123**

- **Reportable Conditions**
- **Material Weaknesses**
- **Report Preparation**

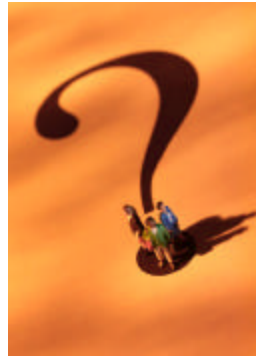
In Lesson 6, you learned what are reportable conditions and that if the conditions are realized in your business unit, you must take timely and effective action to correct the deficiencies. You identified and evaluated materiality with specific reference to some of the current weaknesses, to include Real Property, Military Equipment, Environmental Liabilities, and Fund Balance With Treasury (FBWT).

Next, you examined the methodology for correcting internal control deficiencies (material or not) and then studied the format for reporting internally within the Department, covering the both operational and financial reporting deficiencies.

In discussing reporting, you learned that annually, management must provide assurances on internal control in its PAR, including a separate assurance on internal control over financial reporting, along with a report on identified material weaknesses and corrective actions.

We reviewed the MIC Program as it relates to financial reporting processes. For a complete understanding of the DoD MIC Program, refer to the DoDD 5010.38, DoDI 5010.40, and the MIC Program Annual Guidance.

Let's continue with the final examination.



Before we move on to the Final Examination, do you have any questions on the course material?

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## Appendix A. Glossary

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This glossary should serve as a reference tool for DoD personnel who need an understanding of auditing terminology. It is not all-inclusive and reflects both acronyms and terms introduced throughout this course.

<b>ABL</b>	Accounting Business Line
<b>Acquisition</b>	To come into possession or control, by purchase or other means, of a new or improved asset.
<b>AcSEC</b>	Accounting Standards Executive Committee (of the AICPA)
<b>ADP</b>	Automated Data Processing is the use of computer equipment to facilitate accounting, budgeting, and other processes.
<b>AICPA</b>	American Institute of Certified Public Accountants
<b>AIMD</b>	Accounting and Information Management (GAO)
<b>Allocation Assertion</b>	See Valuation
<b>Amortization</b>	The periodic recognition of the consumption (expense) of an intangible asset
<b>AR</b>	Army Regulation
<b>ASA</b>	Annual Statement of Assurance
<b>Assertion</b>	Explicit and implicit information provided by management that attests to the represented financial position or results of operations
<b>Assertion Letter</b>	A representation by management that a financial statement or line item is ready for audit
<b>Assessable Unit</b>	An organizational subdivision and part of the total organization that requires compliance with the IC Program for a Department component.
<b>Asset</b>	The property owned by an entity. Assets are classified in several ways, including assets that are tangible and intangible. While tangible assets are more easily defined, intangible assets are those long-lived assets useful in the operation of entity that are not held for sale and have no physical qualities. Examples of intangible assets include patents, copyrights, franchises, trademarks, trade names, and goodwill.
<b>AT&amp;L</b>	Acquisition, Technology, and Logistics is an office located within the Office of the Secretary of Defense.

<b>AU</b>	Assessable Unit
<b>Auditable</b>	The condition where underlying data and procedures are sufficient, accurate, testable, and reliable enough for an auditor to obtain a basis for forming an unqualified opinion
<b>Audit Ready</b>	The condition where underlying data is auditable and the staff is ready to support that data in an audit process
<b>Audit Risk</b>	A risk taken when an auditor unknowingly fails to modify his or her opinion appropriately on financial statements that are materially misstated
<b>Audit Trail</b>	A chain of evidence provided by coding, cross-references, and documentation connecting account balances and other summary results with original transaction data.
<b>Benchmark</b>	A standard against which others are measured
<b>Best Practice</b>	A process or procedure that can be used as a good example for others in similar organizations.
<b>BMMP</b>	The Business Management Modernization Program is a vehicle designed to transform business operations and improve oversight and accountability for the billions of dollars spent designing, building, operating, and maintaining business systems that support the Department's primary missions.
<b>BRAC</b>	Base Realignment and Closure. The Congressional mandate to eliminate excess physical capacity. The operation, sustainment, and recapitalization of that which diverts scarce resources from Defense capability
<b>Capitalize</b>	To record and carry forward into one or more future periods any expenditure from which the benefits will then be realized
<b>CFO</b>	A Chief Financial Officer is an organization's senior financial executive.
<b>CFOA</b>	The Chief Financial Officers Act of 1990 is intended to improve financial management systems and information to produce timely, reliable, and comprehensive financial information.
<b>CFOC</b>	The Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies, senior officials of the Office of Management and Budget, and the Department of the Treasury, who work collaboratively to improve financial management in the U.S. government.
<b>CIP</b>	Construction-in-Progress
<b>Completeness Assertion</b>	An assertion about whether all transactions and accounts that should be presented in the financial statements are so included.



<b>Compliance</b>	The conformity to the rule of law, standard practice, or specified procedure.
<b>Control, Operation, and Design Deficiencies</b>	These are defects in the processes that will prevent the detection of misstatements on a timely basis or the completion of mission objectives.
<b>Cost Risk</b>	Is the risk associated with the ability of the program to achieve its life cycle cost objectives. Two risk areas bearing on cost are (1) the risk that the cost estimates and objectives are not accurate and reasonable and (2) the risk that program execution will not meet the cost objectives as a result of a failure to mitigate technical risks.
<b>COTS</b>	Commercial Off-the-Shelf
<b>CTC</b>	Cost-to Complete refers to the estimated cost for future cleanup of environmental contamination (also includes response actions to address unexploded ordnance (UXO), discarded military munitions (DMM), and munitions constituents (MC)) at past and present DoD sites.
<b>Cycle Memorandum</b>	A depiction in words and/or a diagram form of the activities relating to a particular type of transaction such as the revenue cycle, expenditure cycle, financing cycle, personnel services cycle, or production cycle.
<b>DCAA</b>	The Defense Contract Audit Agency is responsible for performing all contract audits for the Department, and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration.
<b>D.C.</b>	District of Columbia
<b>DCPS</b>	Defense Civilian Pay System
<b>DD</b>	Department of Defense (Form)
<b>DeCA</b>	The Defense Commissary Agency intends to deliver the premier quality of life benefit to the armed services community to enhance recruiting, retention and readiness by efficiently and effectively providing exceptional savings and excellent products and services – every time, every place.
<b>Depreciation</b>	The allocation of the cost of an asset over a period of time for accounting and/or tax purposes; also, a decline in the value of property due to general wear and tear or obsolescence.
<b>DERP</b>	Defense Environmental Restoration Program
<b>DFAR</b>	Defense Federal Acquisition Regulation

<b>DFAS</b>	The Defense Finance and Accounting Service has the mission to provide responsive, professional finance and accounting services for the people who defend America.
<b>Deficiency</b>	In an audit, the term deficiency describes a lack in adequate competence, readiness, knowledge, or means. It may be synonymous with fault.
<b>DISA</b>	Defense Information Systems Agency
<b>Disclosure</b>	Making something known to the public, as in disclosing the financial position of an entity through the publishing of its financial statements and accompanying notes.
<b>DLA</b>	The Defense Logistics Agency provides worldwide logistics support for the missions of the military departments and the Unified Combatant Commands under conditions of peace and war. It also provides logistics support to other DoD components and certain federal agencies, foreign governments, international organizations, and others as authorized.
<b>DMM</b>	Discarded Military Munitions
<b>DoD</b>	Department of Defense (also referred to as the Department)
<b>DoDD</b>	Department of Defense Directive
<b>DoDI</b>	Department of Defense Instructions
<b>DoDFMR</b>	Department of Defense Financial Management Regulation (7000.14-R)
<b>DoD OIG</b>	Department of Defense Office of the Inspector General
<b>DWCF</b>	Defense Working Capital Fund
<b>EDA</b>	Electronic Document Access
<b>EFT</b>	Electronic Funds Transfer
<b>ENG</b>	Engineer
<b>Entity</b>	An organization, unit, or body, such as a department, fund, agency, or section.
<b>ESC</b>	Executive Steering Committee
<b>Evidential Matter</b>	Audit evidence that consists of underlying accounting data or financial records and all corroborating information available to an auditor.

<b>Existence Assertion</b>	An assertion about whether assets or liabilities of an entity exist at a given date, and whether recorded transactions have occurred during a given period; also called existence or occurrence.
<b>Existence or Occurrence</b>	See Existence Assertion.
<b>FAM</b>	The Financial Audit Manual is a manual established by the GAO/PCIE to ensure that the financial statement audits have their intended outcome.
<b>FAR</b>	Federal Acquisition Regulation
<b>FASAB</b>	The Federal Accounting Standards Advisory Board has the mission to promulgate federal accounting standards after considering the financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and the needs of other users of federal financial information.
<b>FASB</b>	Federal Accounting Standards Board
<b>FBWT</b>	Fund Balance With Treasury
<b>FFMIA</b>	The Federal Financial Management Improvement Act builds on the CFO Act by emphasizing the need for agencies to have systems that can generate timely, accurate, and useful information with which to make informed decisions and to ensure accountability on an ongoing basis.
<b>FII</b>	The Financial Improvement Initiative promotes the achievement of an unqualified opinion on the Department's consolidated financial statements by FY07.
<b>FISMA</b>	Financial Information Security Management Act of 2002
<b>FMFIA</b>	The Federal Manager's Financial Integrity Act requires federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. It further requires that, each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of internal control and financial systems that protect the integrity of agency programs and administrative activities.
<b>FMMP</b>	The Financial Management Modernization Program was renamed the BMMP on May 20, 2003.
<b>FMR</b>	Financial Management Regulation (see DoDFMR)

<b>FMS</b>	The Foreign Military Sales program manages government-to-government purchases of weapons and other defense articles, defense services, and military training.
<b>FSRE</b>	Financial Statement Reporting Entity
<b>FUDS</b>	Formally Used Defense Sites is a type or classification of site, comparable to DoD installation or BRAC site.
<b>FY</b>	Fiscal Year
<b>GAAP</b>	General accepted accounting principles are the common set of accounting principles, standards, and procedures. GAAP is a combination of authoritative standards (set by policy boards) and the accepted ways of doing accounting.
<b>GAGAS</b>	Generally Accepted Government Auditing Standards
<b>GAO</b>	The Government Accountability Office, previously called the General Accounting Office, is an independent, nonpartisan agency that works for Congress. The GAO is often called the “congressional watchdog” because it investigates how the federal government spends taxpayers’ dollars.
<b>GAO/PCIE</b>	Government Accountability Office/President’s Council on Integrity and Efficiency. The PCIE was established in 1992 to address integrity, economy, and effectiveness issues that transcend individual government agencies, and increase the professionalism and effectiveness of IG personnel throughout the government.
<b>GMRA</b>	The Government Management Reform Act of 1994 updated the CFOA by setting standards for the effectiveness of financial management reporting.
<b>GPRA</b>	The Government Performance and Results Act of 1993 aims to improve federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction.
<b>GRS</b>	The General Records Schedule is issued by the Archivist of the United States to provide disposition authorization for records common to several or all agencies of the federal government.
<b>GS</b>	General Schedule
<b>GSA</b>	General Services Agency
<b>IAW</b>	In accordance with
<b>IBM</b>	International Business Machines

<b>IC</b>	Internal Control
<b>IC Assessment</b>	A documented assessment on the effectiveness and adequacy of the system to meet mission objectives, implemented in a cost effective way.
<b>ID</b>	Identification
<b>IG</b>	The Inspector General has traditionally served as “an extension of the eyes, ears, and conscience of the Commander.” Pursuant to the Inspector General Act of 1978, as amended, “the Inspector General of the Department of Defense shall ... be the principal adviser to the Secretary of Defense for matters relating to the prevention of fraud, waste, and abuse in the programs and operations of the Department.”
<b>IGT</b>	Intergovernmental Transaction
<b>IMPAC</b>	International Merchant Purchase Authorization Card
<b>Internal Control</b>	Refers to processes that are designed to provide reasonable assurance regarding the achievement of objectives in the reliability of financial reporting, compliance with applicable laws and regulations, and the effectiveness and efficiency of operations
<b>Internal Review</b>	An inspection of processes and data of an entity by personnel employed by or internal to the entity
<b>IPA</b>	Independent Public Accountant
<b>IPIA</b>	Improper Payments Information Act
<b>JFMIP</b>	The Joint Financial Management Improvement Program is a joint and cooperative undertaking of the Department of the Treasury, the GAO, the OMB, and the OPM working in cooperation with each other and other agencies to improve financial management practices in government.
<b>Liability</b>	A legal responsibility or accountability for an amount owed
<b>Materiality</b>	In an audit, materiality refers to the degree of importance or consequence.
<b>MC</b>	Management Control (see also MCP)
<b>MCE</b>	Management Control Evaluation
<b>MCP</b>	A Management Control Program (MCP) provides reasonable assurance that obligations and costs comply with applicable laws and emphasizes prevention of waste, fraud, mismanagement, and timely corrections of MC weaknesses.

<b>MD&amp;A</b>	The Management and Discussion and Analysis section, found on financial statements, allows management to discuss aspects of an entity's financial statement that may be otherwise difficult to locate. It provides a summary and more.
<b>MIC</b>	The Managers' Internal Control Program provides a process to help managers assess, document, and report a level of assurance over their internal controls.
<b>MIPR</b>	Military Interdepartmental Purchase Request
<b>MOA</b>	Memorandum of Agreement
<b>MOU</b>	Memorandum of Understanding
<b>N/A</b>	Not available
<b>NAF</b>	Non-Appropriated Fund
<b>NARA</b>	The National Archives and Records Administration ensures for the citizens and the public servant, for the President, Congress, and Courts, ready access to essential evidence.
<b>NAS</b>	Naval Audit Service
<b>NDPP&amp;E</b>	The National Defense PP&E was previously expensed in the period incurred, but all are now classified as general PP&E and capitalized, with the exception of the cost of land and land improvements that produce permanent benefits, which are depreciated.
<b>No.</b>	Number
<b>Non-statistical Sampling</b>	A group of methods used in audits to determine the size of a sample to be tested and the evaluation of the results that is less objective and more subjective and judgmental than the statistical sampling approach
<b>NORM</b>	Normalization of Data System
<b>NRV</b>	Net Realizable Value is a valuation method.
<b>NULO</b>	Negative Unliquidated Obligations
<b>O&amp;M</b>	Operations and Maintenance

<b>OFFM</b>	The Office of Federal Financial Management was created within the OMB by the CFOA of 1990. The OFFM is responsible for the financial management policy of the federal government including implementing the financial management improvement priorities of the President, establishing government-wide financial management policies of executive agencies, and carrying out the financial management functions of the CFOA.
<b>OIG</b>	Office of the Inspector General
<b>OMB</b>	The Office of Management and Budget has a mission to assist the President in overseeing the preparation of the federal budget and to supervise its administration in Executive Branch agencies.
<b>OM&amp;S</b>	Operating Material and Supplies
<b>OPM</b>	The Office of Personnel Management is the federal government's human resource agency.
<b>OPR</b>	Office of Primary Responsibility
<b>OSD</b>	Office of the Secretary of Defense
<b>OUSD(C)</b>	Office of the Under Secretary of Defense (Comptroller)
<b>OUSD(HA)</b>	Office of the Under Secretary of Defense (Health Affairs)
<b>PAD</b>	Process Analysis Document is a document used to identify the processes and controls used by your organization.
<b>P&amp;EP</b>	Property and Equipment Policy
<b>PAR</b>	Performance and Accountability Report is designed to provide useful information for American citizens, the President, Congress, other federal organizations, and DoD Military members, civilians and contractors. Contained in five parts, it provides a thorough description of the Department's services to the American people and stewardship of their critical resources.
<b>PART</b>	Program Assessment Rating Tool
<b>POM</b>	Program Objective Memorandum
<b>PBC</b>	A Prepared by Client list is a list that facilitates the audit process by coordination with specific points-of-contact.

<b>PCIE</b>	The President's Council on Integrity and Efficiency was established to address integrity, economy, and effectiveness issues that transcend individual government agencies, and increase the professionalism and effectiveness of IG personnel throughout the government.
<b>P&amp;EP</b>	Property and Equipment Policy
<b>PMA</b>	The President's Management Agenda is an aggressive strategy for improving the management of the federal government. It focuses on five areas of management weaknesses across the government where improvements and the most progress can be made.
<b>PMO</b>	Program Management Office
<b>POC</b>	Point of Contact
<b>Population</b>	In an audit, a population is a class of transactions or the account balance to be tested.
<b>PP&amp;E</b>	Property, Plant, and Equipment
<b>Preponderant Use</b>	Preponderant use is the policy found in SFFAS No. 4 that mandates that the entity report on their financial statement the full cost of material items that are significant to the receiving entity and form an integral or necessary part of the entity's output.
<b>Presentation and Disclosure Assertion</b>	This assertion ensures the financial report is presented in the proper form and the required disclosures are present.
<b>Qualified Opinion</b>	An auditor's opinion stating that except for the effects of the matter(s) to which the qualification relates, the financial statements present the position of the organization fairly.
<b>RA</b>	Risk Assessment
<b>RACER</b>	Remedial Action Cost Engineering Requirements
<b>Readiness</b>	See Audit Ready.
<b>Reasonable Assurance</b>	Assurance that a reasonable person can reach the same conclusion given the same data and circumstances; not an absolute certainty
<b>RDTE</b>	Research, Development, Test, and Evaluation
<b>RFA</b>	Ready for Audit



<b>Rights and Obligations Assertion</b>	An assertion about whether assets are the rights of the entity, and liabilities are the obligations for the entity, at a given date
<b>Risk</b>	This is the probable or potential adverse effects from inadequate IC that may result in the loss of government resources or cause an agency to fail to accomplish significant mission objectives through fraud, error, or mismanagement.
<b>Risk Assessment</b>	This is how management identifies internal and external risks that may prevent the organization from meeting its objectives.
<b>RPC</b>	Review and Prioritization Committee
<b>RPS</b>	Review and Prioritization Sub-committee
<b>Sample</b>	In an audit, a sample is a single unit within a class of transactions or account balances to be tested.
<b>SARS</b>	Suspense Account Reports
<b>SAS</b>	Statements of Accounting Standards
<b>Schedule risk</b>	Is the risk associated with the adequacy of the time estimated and allocated for the development, production, and fielding of the system. Two risk areas bearing on schedule risk are (1) the risk that the schedule estimates and objectives are not realistic and reasonable and (2) the risk that program execution will fall short of the schedule objectives as a result of failure to mitigate technical risks
<b>SDN</b>	Standard Document Number
<b>SEC</b>	Securities and Exchange Commission
<b>SECDEF</b>	Secretary of Defense
<b>SFFAC</b>	Statement of Federal Financial Accounting Concepts
<b>SFFAS</b>	Statement of Federal Financial Accounting Standards is the standards issued by the FASAB to implement the GAAP for the federal government.
<b>SOA</b>	Statement of Accountability
<b>SOP</b>	Standard Operating Procedure
<b>SOX</b>	Sarbanes-Oxley Act

<b>Source Documentation</b>	Documents representing authorization for original transactions and associated with transaction data. These documents include contracts, invoices, funding authorizations, bills of lading, receiving reports, titles, mortgages or notes, leases, agreements, appointments, signature cards, policies, and others.
<b>Statistical Sampling</b>	A mathematical method or combination of methods used to determine the number of items in a population to examine
<b>SQL</b>	Structured Query Language
<b>Systemic (Weakness)</b>	Describes a problem involving one or more financial reporting systems that results in an inability to provide accurate, reliable, or timely financial data
<b>TDY</b>	Temporary Duty
<b>Technical Risk</b>	Is the risk associated with the evolution of the design, production and supportability of a system affecting the level of performance necessary to meet the operational requirements
<b>Testing</b>	Procedures to determine, through observation, examination, verification, sampling, or other methods, whether an internal control system is working as intended.
<b>TFM</b>	Treasury Financial Manual
<b>TI</b>	Treasury Index is the Treasury's code for the various funds used in the federal government. Examples in DoD include TI 97, 57, 21, and 17.
<b>TTB</b>	Treasury Trial Balance
<b>ULO</b>	Unliquidated Obligation
<b>UMD</b>	Unmatched Disbursement
<b>Unqualified Opinion</b>	An auditor's opinion that is without any material exception as to a general statement of reliability of the items specified within the limits of an audit
<b>U.S.</b>	United States
<b>USACE</b>	United States Army Corps of Engineers
<b>UXO</b>	Unexploded Ordnance
<b>USD</b>	Under Secretary of Defense
<b>USD(C)</b>	Under Secretary of Defense, Comptroller

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<b>USSGL</b>	United States Government Standard General Ledger provides a uniform Chart of Accounts and technical guidance to be used in standardizing federal agency accounting.
<b>USTRANSCOM</b>	The United States Transportation Command is a unified command composed of elements from each of the services to provide air, land, and sea transportation for the DoD.
<b>Validation</b>	The corroboration, substantiation, or confirmation of relevant or meaningful information, supported by objective truth or generally accepted authority
<b>WCF</b>	The Working Capital Fund was established to be self-sustaining where products or services are produced and sold to recover the full cost of operations.
<b>WIP</b>	Work in Progress

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## Appendix B. Reference Documents

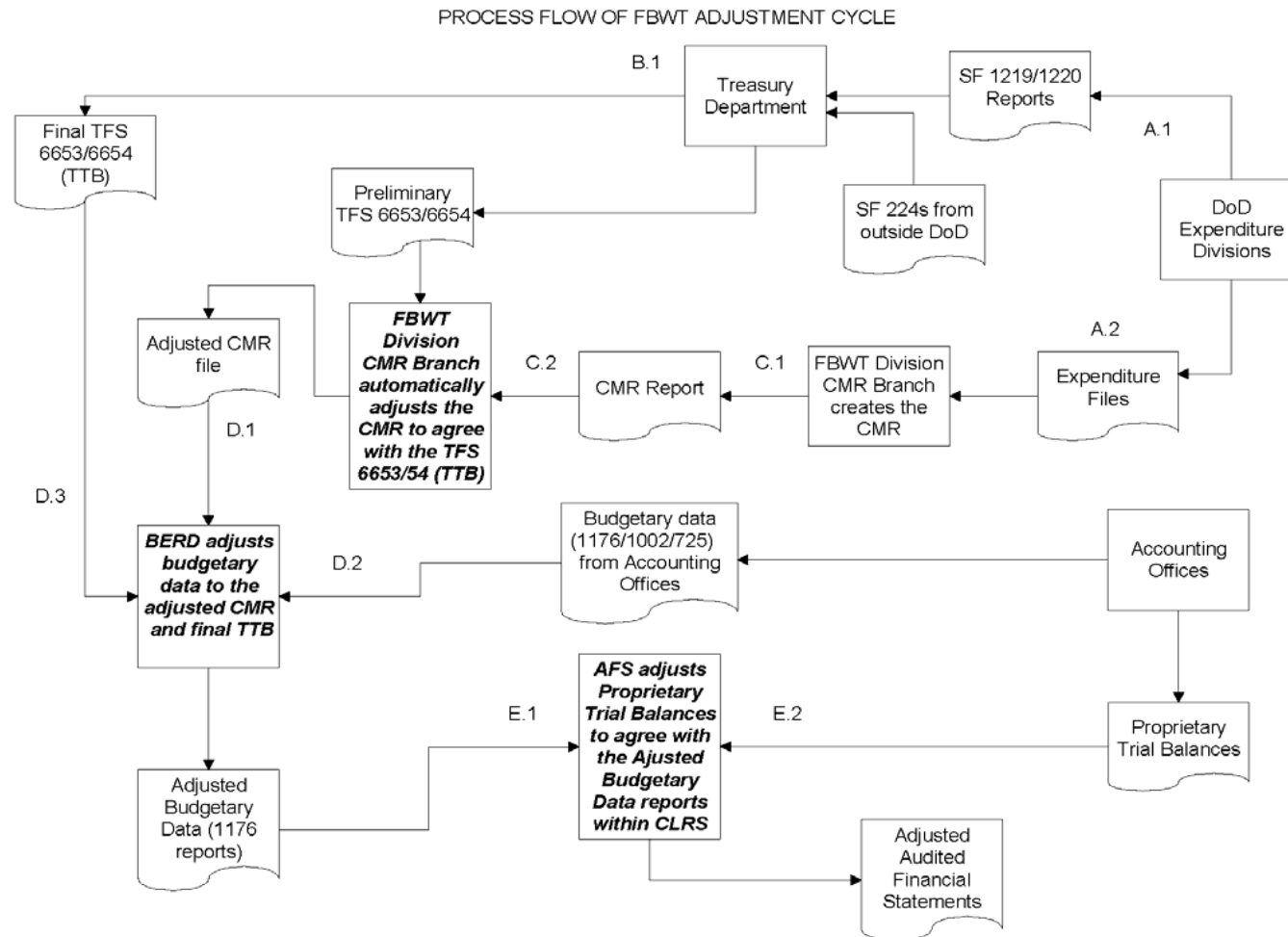
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This appendix provides requirements for many reference documents. The document covering the Process Flow of FBWT Adjustment Cycle consolidates individual flow charts to describe the FBWT adjustment process. The document covering Risk Analysis provides a sample of formats that can be used in your business processes. The document covering the Example Standard Operating Procedure (SOP) provides an example SOP for DFAS Accounting Services – Navy, emphasizing documentation, tracking, and reporting requirements. The document covering Cycle Memorandum Requirements provides specific areas that the cycle memorandum must address. The document covering the Memorandum of Agreement (MOA) outlines the support for recorded book cost of General Property, Plant, and Equipment Assets, U.S. Army Corps of Engineers, Civil Works.

Document Name	Page Number
Process Flow of FBWT Adjustment Cycle	B-2
Sample Risk Analysis Format	B-12
Example Standard Operating Procedure (SOP)	B-15
Cycle Memorandum Requirements	B-41
Memorandum of Agreement	B-44

## Process Flow of FBWT Adjustment Cycle

Purpose: To consolidate individual flowcharts to describe the FBWT Adjustment process.  
Source: Shaun Pickering, Team Lead Assistant, (816) 926-5523; workpaper B.2.150



## PROCESS FLOW OF FBWT ADJUSTMENT CYCLE

## A. DoD EXPENDITURE DIVISIONS

- 1) For the purposes of this process chart, the main function of the DoD Expenditure Divisions is to compile all of the current month's disbursements and collections and forward them to the Treasury Department via the SF1219/1220.
- 2) DoD Expenditure Divisions' secondary function as it relates to this process chart is to make available the current month's disbursements and collections to the Fund Balance With Treasury Division, Cash Management Report Branch.

## B. TREASURY DEPARTMENT

- 1) Treasury receives the SF 1219/1220s from the DoD Expenditure Divisions in addition to all other government department/agency expenditure data (SF 224s); compiles the data into the TFS 6653/6654, otherwise known as the Treasury Trial Balances.

## C. FUND BALANCE WITH TREASURY (FBWT) DIVISION, CASH MANAGEMENT REPORT (CMR) BRANCH

- 1) FBWT CMR Branch downloads the current month's expenditure files from the DoD Expenditure Divisions to create the Cash Management Report (CMR) and also downloads the current month's TFS 6653/6654 from Treasury. Most of the time, the TTB is downloaded twice. The first download is called the preliminary TTB. The second download is the final TTB. (**Note:** The CMR is presented by appropriation down to the four-position limit level. The Treasury Trial Balance (TTB) prepared by Treasury is presented by appropriation but only to the basic symbol level<sup>1</sup>)
- 2) A PC-based program used by FBWT CMR Branch then automatically adjusts the CMR to the preliminary Treasury Trial Balance (TTB).
  - a. Differences are classified as "undistributed" amounts and recorded using accounts at the .5 level for the Working Capital Funds. Examples are .5C99 and .5L99
  - b. The CMR for the General Fund accounts to Treasury is "balanced" to Treasury using account limits 99SA, to account for the amount needed to bring the two reports into agreement. Amounts cannot be identified to a specific Defense Agency.
  - c. The total amounts of the adjustments for the months ending March 31, June 30 and September 30, 2003 were in excess of \$(172) billion, net and \$179 billion absolute. Amounts cannot

<sup>1</sup> Within a line of accounting such as 973/40100.1321, the first two digits, 97, is the Treasury Index (TI). TI97 denotes DoD. The third, fourth and fifth digits are the fiscal year. In this case, 2003/2004. The basic symbol of the appropriation is digits six through nine: 0100. The tenth through the thirteenth digits denote the limit or subhead of the appropriation: .1321. A defense agency can be identified by the first two positions of the limit: .13, and further defined by all four positions of the limit: .1321. Limit 9999 is used for amounts that are unidentifiable to any agency.

be identified to a specific Defense Agency. See Table *CMR to Prelim TTB Adj.*

D. BUDGET EXECUTION and REPORTING DIVISION (BERD)

- 1) BERD receives the adjusted CMR and loads it into the TI 97 Budget Execution Reports Application (a local FoxPro database).
- 2) As BERD receives and loads the monthly budget execution reports (DD 1176/1002/725) from the Accounting Offices for each appropriation into the TI 97 Budget Execution Reports Application, the budgetary reports are being automatically adjusted to the CMR at the four-position limit level (**Note:** No documentation is printed or retrieved from the TI 97 Budget Execution Reports Application to show that an adjustment to the CMR has been made) within the FoxPro database.
  - a. See Table *CMR Adjustment by Agency* for analysis of these adjustments based on agency (DLA, DISA, MDA, DARPA, and DHP).
  - b. BERD later receives the final TTB and loads it into the TI 97 Budget Execution Reports Application. The TI 97 Budget Execution Reports Application automatically adjusts the budgetary reports to the TTB. The journal vouchers for the TTB adjustments are recorded at the basic symbol level and are coded to a "9999" limit. See Table *BERD Adj to Final TTB.*

E. AUDITED FINANCIAL STATEMENTS DIVISION (AFS)

- 1) AFS extracts certain line items off of the DD 1176 that is made available by BERD.
- 2) AFS receives Proprietary Trial Balances from the Accounting Offices and then adjusts the Proprietary Trial Balances to the DD 1176 line items within the CFO (Chief Financial Officer) Load and Reconciliation System (CLRS). See Table *AFS CLRS Adjustment by Agency*
  - a. When there still remains a difference between budgetary data and the proprietary information after all adjustments have been made to the limit level, the difference is recorded in limit "9999". See Table *AFS CLRS "9999" Adj.*

## CMR Adj to Prelim TTB

CMR Adjustments to Treasury Trial Balance (TTB) for selected months of FY 2003  
Adjustments made to "99SA" limit level.

Balancing of CMR to Preliminary Treasury Trial Balance (TFS 6653/6654)

<b>Mar-03</b>		
Net Dollar	(\$173,432,726,574.11)	
Absolute Dollar	\$180,208,339,012.23	
Volume of Line Items on Journal Voucher		104
<b>Jun-03</b>		
Net Dollar	(\$172,442,851,755.83)	
Absolute Dollar	\$180,856,869,932.17	
Volume of Line Items on Journal Voucher		112
<b>Sep-03</b>		
Net Dollar	(\$173,492,235,325.32)	
Absolute Dollar	\$179,788,426,075.56	
Volume of Line Items on Journal Voucher		102



## BERD to CMR Adj by Agency

BERD CMR Adjustments for selected months of FY 2003					
Adjustments made to four-position agency limit level.					
Balancing of Budgetary records to CMR					
	DARPA	DHP	DISA	MDA	DLA
<b>Mar-03</b>					
Net Dollar	(\$47,220,534.55)	\$358,759,045.66	(\$318,551,705.43)	\$133,393,685.22	\$44,124,703.31
Absolute Dollar	\$420,664,567.57	\$3,239,618,419.97	\$1,364,355,803.45	\$1,589,251,604.32	\$965,530,186.43
Volume of Transactions	110	190	72	126	38
<b>Jun-03</b>					
Net Dollar	(\$47,345,220.52)	\$367,995,522.84	(\$318,551,705.44)	\$124,754,414.76	\$44,124,334.31
Absolute Dollar	\$392,168,983.34	\$1,248,348,238.26	\$1,236,711,949.10	\$1,920,185,965.02	\$966,358,549.11
Volume of Transactions	113	201	76	123	41
<b>Sep-03</b>					
Net Dollar	(\$46,475,705.96)	\$369,138,354.92	(\$318,551,705.44)	\$121,606,569.35	\$44,124,334.29
Absolute Dollar	\$409,685,547.78	\$1,300,387,059.70	\$1,893,976,792.52	\$1,853,528,093.13	\$971,287,394.19
Volume of Transactions	115	216	80	126	39

## BERD Adj to Final TTB

BERD TTB Adjustments for selected months of FY 2003				
Adjustments made to limit "9999".				
	Month JV was made	Debit Amount of JV	Credit Amount of JV	Amount of Adjustment to Budgetary Records
2nd Quarter	March	\$2,759,137,349.84	\$3,486,761,029.92	(\$727,623,680.08)
3rd Quarter	June	\$1,970,367,242.14	\$3,040,488,850.66	(\$1,070,121,608.52)
4th Quarter	September	\$2,428,563,360.52	\$3,141,186,806.86	(\$712,623,446.34)

## AFS CLRS Adjustment by Agency

Balancing of Proprietary Records to Budgetary Records					
Detail for this sheet is shown in worksheet <i>AFS CLRS Adj</i>					
	DARPA	DHP	DISA	MDA	DLA
<b>FY 2003 2nd Qtr</b>					
Net Dollar	863,157,577.41	928,758,415.93	(175,953,417.05)	(108,440,627.10)	120,104,051.51
Absolute Dollar	\$863,157,577.41	\$1,034,031,581.39	\$180,237,306.53	\$327,605,744.50	136,401,370.57
<b>FY 2003 3rd Qtr</b>					
Net Dollar	\$575,636,596.39	\$730,610,067.60	\$134,663,962.83	\$38,884,368.99	\$142,240,467.00
Absolute Dollar	\$668,959,237.33	\$847,407,068.38	\$205,202,952.93	\$93,807,507.75	\$158,781,684.94
<b>FY 2003 4th Qtr</b>					
Net Dollar	18,140,973.52	378,753,874.58	(543,332,464.23)	(278,771,526.14)	62,805,215.24
Absolute Dollar	\$18,140,973.52	489,082,515.04	553,362,376.35	278,771,526.14	82,332,366.28

## AFS CLRS Adj

AFS CLRS Adjustments for selected quarters of FY 2003				
Adjustments made to two-position limit level.				
	Dept, BS, Limit, FY	Entity Code	Reference Number	F�WT Adjustment Amount
<b>CLRS</b>				
<b>2nd Quarter</b>				
		AT97AG6_1300	JV0635000ZZZ	863,157,577.41
		AT97AC3_1800	JV0635000ZZZ	899,750,773.07
		AT97AG6_1800	JV0635000ZZZ	(52,636,582.73)
		AT97AF6_1800	JV0635000ZZZ	81,644,225.59
		AT97AG6_5100	JV0635000ZZZ	1,633,612.60
		AT97AF6_5100	JV0635000ZZZ	(4,703,390.03)
		AT97AC3_5100	JV0635000ZZZ	52,671,156.94
		AT97AH6_5100	JV0635000ZZZ	73,899,983.43
	97-4093-5100		JV0635000ZZZ	47,958.07
	97-0833-5100		JV0635000ZZZ	(3,445,269.50)
		AT97AG6_2500	JV0635000ZZZ	(178,095,361.79)
		AT97AF6_2500	JV0635000ZZZ	806,877.82
		AT97AH6_2500	JV0635000ZZZ	1,335,066.92
	97-0500-4300		JV0635000ZZZ	(111,389.20)
	97-0833-4300		JV0635000ZZZ	108,115,311.37
		AT97AG6_4300	JV0635000ZZZ	1,467,247.33
		AT97AF6_4300	JV0635000ZZZ	(64,468,255.22)
		AT97AC3_4300	JV0635000ZZZ	(153,443,541.38)
<b>3rd Quarter</b>				
		AT97AG6_1300	JV0935001ZZZ	(\$46,661,320.47)
		AT97AG6_1300	JV0935000ZZZ	\$622,297,916.86
		AT97AC3_1800	JV0935001ZZZ	\$718,358,663.83
		AT97AF6_1800	JV0935002ZZZ	\$70,649,904.16
		AT97AG6_1800	JV0935001ZZZ	(\$57,823,574.39)
		AT97AF6_2500	JV0935000ZZZ	\$789,981.00
		AT97AF6_2500	JV0935001ZZZ	\$68,147,524.89
		AT97AG6_2500	JV0935001ZZZ	(\$35,236,905.96)
		AT97AH6_2500	JV0935000ZZZ	\$5,120,000.00
		AT97AH6_2500	JV0935001ZZZ	(\$32,589.09)
		AT97AC3_5100	JV0935002ZZZ	\$92,627,766.96
		AT97AF6_5100	JV0935000ZZZ	\$426,260.40
		AT97AF6_5100	JV0935001ZZZ	(\$5,555,962.52)
		AT97AG6_5100	JV0935001ZZZ	\$5,222,514.68
		AT97AH6_5100	JV0935000ZZZ	\$20,183,006.19
		AT97AH6_5100	JV0935001ZZZ	\$29,574,498.92
		AT97AH6_5100	JV0935002ZZZ	(\$2,714,646.45)
		AT97AM6_5100	JV0935001ZZZ	\$24,545.06
		AT97AG6_5100	JV0935000ZZZ	\$2,304,525.69
		AT97AM6_5100	JV0935000ZZZ	\$47,958.07
		AT97AH6_4300	JV0935001ZZZ	\$4,000.00
		AT97AC3_4300	JV0935002ZZZ	\$36,309,000.38
		AT97AF6_4300	JV0935001ZZZ	(\$27,461,569.38)
		AT97AC3_1800	JV0933009GDM	(\$574,926.00)
		AT97AG6_4300	JV0935001ZZZ	\$30,022,937.99
		AT97AG6_4300	JV0935002ZZZ	\$10,000.00
		AT97AC3_5100	JV0935000ZZZ	\$100,000.00

## AFS CLRS Adj

		AT97AG6_2500	JV0935000ZZZ	\$95,875,951.99
	4th Quarter	AT97AG6_1300	JV1235000ZZZ	18,140,973.52
		AT97AC3_1800	JV1235000ZZZ	375,737,072.90
		AT97AF6_1800	JV1235000ZZZ	58,181,121.91
		AT97AG6_1800	JV1235000ZZZ	(55,164,320.23)
		AT97AH6_2500	JV1235000ZZZ	5,014,956.06
		AT97AF6_2500	JV1235000ZZZ	(31,531,588.37)
		AT97AG6_2500	JV1235000ZZZ	(516,815,831.92)
		AT97AC3_4300	JV1235000ZZZ	(172,273,564.31)
		AT97AF6_4300	JV1235000ZZZ	(51,859,767.26)
		AT97AG6_4300	JV1235000ZZZ	(54,522,805.37)
		AT97AH6_4300	JV1235000ZZZ	(115,389.20)
		AT97AC3_5100	JV1235000ZZZ	45,368,326.97
		AT97AF6_5100	JV1235000ZZZ	(4,703,390.03)
		AT97AG6_5100	JV1235000ZZZ	(173,696.31)
		AT97AH6_5100	JV1235002ZZZ	(28,000.00)
		AT97AH6_5100	JV1235000ZZZ	27,200,463.79
		AT97AM6_5100	JV1235000ZZZ	(4,858,489.18)
				\$2,887,257,536.48

## AFS CLRS "9999" Adj

AFS CLRS Adjustments for selected quarters of FY 2003						
Adjustments made to "9999" limit.						
Dept, BS, Limit, FY	Entity Code	JV Control Number	Reference Number	FBWT Adjustment Amount	Net Adjustment Amount	Absolute Adjustment Amount
<b>CLRS</b>						
<b>2nd Quarter</b>						
97 0134 9999 NA			JV0635000ZZZ	\$137,515,032.36		
97 0500 9999 NA			JV0635000ZZZ	\$182,469,000.00		
97 0819 9999 NA			JV0635000ZZZ	\$4,990,000.00		
97 0811 9999 X			JV0635000ZZZ	\$410.07		
97 0801 7000 X			JV0635000ZZZ	\$921,316,000.00		
97 0706 9999 NA			JV0635000ZZZ	\$1,313,000.00		
97 0834 9999 X			JV0635000ZZZ	\$11,027,417.97		
97 5193 9999 X			JV0635000ZZZ	\$816,659.56		
97 5189 9999 X			JV0635000ZZZ	\$117,001.68		
97 5188 9999 X			JV0635000ZZZ	\$1,049,879.99		
97 4168 9999 X			JV0635000ZZZ	\$963,482.11		
97 4166 9999 X			JV0635000ZZZ	\$8,523,713.00		
97 0838 9999 X			JV0635000ZZZ	\$18,893,000.00		
97 0840 9999 X			JV0635000ZZZ	\$1,000,000.00		
97 0132 9999 X			JV0635000ZZZ	(\$2,000,000.00)		
97 0118 9999 X			JV0635000ZZZ	\$37,033,000.00		
97 8165 9999 X			JV0635000ZZZ	\$32,641,592.19		
97 0360 9999 X			JV0635000ZZZ	\$1,000,000.00		
97 0803 7000 X			JV0635000ZZZ	\$509,000.00		
97 0839 9999 NA			JV0635000ZZZ	\$720.00		
	AT97AG6_9999		JV0635000ZZZ	\$109,385,457.91		
	AT97AF6_9999		JV0635000ZZZ	\$154,225,000.00		
					\$1,622,789,366.84	\$1,626,789,366.84
<b>3rd Quarter</b>						
	AT97AM6_9999		JV0935000ZZZ	\$575,172,885.18		
	AT97AG6_9999		JV0935000ZZZ	\$262,188,517.91		
	AT97AM6_9999		JV0935001ZZZ	\$191,540,101.48		
	AT97AH6_9999		JV0935001ZZZ	(\$0.47)		
	AT97AG6_9999		JV0935001ZZZ	\$1.46		
	AT97AF6_9999		JV0935001ZZZ	\$0.43		
	AT97AH6_9999		JV0935000ZZZ	\$119,581,000.00		
	AT97AF6_9999		JV0935000ZZZ	\$193,844,000.00		
					\$1,342,326,505.99	\$1,342,326,506.93
<b>4th Quarter</b>						
	AT97AM6_9999		JV1235000ZZZ	\$444,164,444.05		
	AT97AH6_9999		JV1235000ZZZ	\$34,765,495.81		
	AT97AG6_9999		JV1235000ZZZ	\$181,654,279.30		
	AT97AF6_9999		JV1235000ZZZ	(\$41,318,604.58)		
	AT97AH6_9999		JV1235001ZZZ	\$11,623,000.00		
	AT97AM6_9999		JV1235001ZZZ	\$74,485,216.61		
					\$705,373,831.19	\$788,011,040.35

## Risk Analysis

Entity Defense Aircraft Agency (1)\*

Preparer John Doe (2) (3)

Account Line: FBWT

(4) Control Number	(5) Account/ Line Item/Event	(6) Business Cycle, Accounting Application	(7) Assertion	(8) Risk	(9) Risk Factors	(10) Inherent Risk	(11) Control Risk	(12) Combined Risk	(13) Internal Control Currently In Place
1a	Cash Disbursements	Payroll	Valuation/Allocation	The DCPDS will accept invalid data entered by HR	Significant factor	High	Low	Moderate	DCPDS has edits to reject invalid data
1b	Cash Disbursements	Payroll	Completeness	HR omitted data (i.e. pay grade and Social Security number) into employees DCPDS profile	Significant factor	High	Low	Moderate	DCPDS has edits to reject incomplete employees profile
2a	Cash Disbursements	Payroll	Completeness	Employee requested forms are missing (i.e.W4, allotments etc.)	Significant factor	High	High	High	No control was found.
2b	Cash Disbursements	Payroll	Valuation/Allocation	Inaccurate data and wrong version of forms (i.e. W4, allotment etc.)	No Significant risk factor	Low	Low	Low	CSR employee input data and another employee review for accuracy
3a	Cash Disbursements	Payroll	Completeness	Supervisor's signature omitted	No Significant risk factor	Moderate	Low	Moderate	Timekeeper will not input exceptions without assigned supervisor's signature
4a	Cash Disbursements	Payroll	Completeness	Time and attendance omitted (i.e. sick, annual leave etc.)	Significant risk factor	High	Low	Low	Supervisor verifies timesheet with supporting documentation.

Defense Aircraft Agency is a fictitious organization for this example.

Control Analysis									
Entity	Defense Aircraft Agency*								
Preparer	Buck Fawn								
Account Line:	FBWT								
Business Cycle, Accounting Application	Risk	Control Number	Internal Control Currently In Place	(1) Control Test Objective	(2) Description of Design Test	(3) Was Control Design Effective?	(4) Description of Control Operation Test	(5) Was Control Operation Effective?	(6) New Control Risk Level
Payroll	The DCPDS will accept invalid data entered by HR	1a	DCPDS has edits to reject invalid data	To Support that the Control Risk is Low	Input invalid data to verify if data would reject and produce error message	No	Observe HR person input invalid data into the DCPDS	Yes	Moderate
Payroll	HR omitted data (i.e. pay grade and Social Security number) into employees DCPDS profile	1b	DCPDS has edits to reject incomplete employees profile	To Support that the Control Risk is Low	If data is omitted from input screen would DCPDS produce an error message.	No	Observe HR person attempt to omit data (i.e. Social Security number) data into the DCPDS	Yes	Moderate
Payroll	Employee requested forms are missing (i.e. W4, allotments etc.)	2a	CSR has a New Employee's forms check listing	Not Applicable. This is a High Risk area					
Payroll	Inaccurate data and wrong version of forms (i.e. W4, allotment etc.)	2b	CSR employee input data and another employee review for accuracy	To Support that the Control Risk is Low	CSR employee input data and another CSR employee review the forms.	Yes	Examine forms for indication of review	Yes	Low

\* Defense Aircraft Agency is a fictitious organization for this example.



<b>Risk Assessment</b>					
	<b>Event</b>	<b>Event</b>	<b>Event</b>	<b>Event</b>	<b>Event</b>
<b>example</b>	<b>Purchasing</b>	<b>Receiving</b>	<b>Vendor Maintenance</b>	<b>Invoice Processing</b>	<b>Disbursement</b>
<b>High Risk</b>					
Complex programs/operations					
Complex transactions					
Use of accounting estimates					
Extensive manual processes/applications					
Decentralized accounting/reporting functions					
Changes in operating environment					
Significant personnel changes					
New/revamped information systems					
New programs/operations					
New technology					
<b>Moderate Risk</b>					
Amended laws/regulations					
New accounting standards					
Personnel constraints					
Centralized accounting/reporting functions					
Static operating environment					
<b>Low Risk</b>					
Simple operations/accounting transactions					
Low transaction volume					
<b>Management's Risk Assessment</b>					

## Example Standard Operating Procedure (SOP)

<b>STANDARD PROCEDURES</b>	PROCEDURES NO./J.O. NO. 7310.126
CHECK ONE <input checked="" type="checkbox"/> Operating <input type="checkbox"/> Administrative <input type="checkbox"/> Job Outline <input type="checkbox"/> Policy Statements <input type="checkbox"/> Management Guidelines	ORGANIZATION CODE: DFAS-ADB/CL
SUBJECT  Accounting Services-Navy Management Control Program (MCP) Procedures and Guidelines	REVISION NO.  1
	DISTRIBUTION: Accounting Services-Navy
	SUPERSEDES 10/01/03

### 1. PURPOSE AND SCOPE

1.1. The purpose of this procedure is to implement policy and guidance in support of the established Defense Finance and Accounting Service (DFAS) Management Control (MC) Program, with particular emphasis on standardized documentation, tracking, and reporting requirements expected within the Accounting Services-Navy.

1.2. This Standard Operating Procedure (SOP) applies to management and support staff within the Accounting Services-Navy. This SOP will be used in conjunction with the guidance set forth in DFAS 5010.38-R, *Federal Managers' Financial Integrity Act Section 2 Management Control Program, May 2002*.

### 2. INTRODUCTION

2.1. The Accounting Services-Navy MCP fulfills the requirements of the Federal Managers' Financial Integrity Act (FMFIA), Section 2. The MCP comprises the plans, methods, and procedures used to meet mission, goals, and objectives and to prevent and correct fraud, waste, abuse and mismanagement.

2.2. Network managers shall implement comprehensive and adequate MCs within the construct of the Assessable Unit (AU) model to provide reasonable assurance that intended objectives are achieved and requirements of the FMFIA are met. Managers will continuously monitor, evaluate, and improve the effectiveness of the system of MCs and processes.

2.3. The ultimate goal of this SOP is to provide the Accounting Services-Navy management and support staff with the appropriate guidance to ensure MC Program requirements are met and that the appropriate criteria for standardized reporting and documentation are followed.

### 3. RESPONSIBILITIES

\*3.1 The office of primary responsibility (OPR) for the DFAS FMFIA Program is Arlington, DFAS-AR/DPS, Plans and Requirements Directorate, Strategy and Analysis Division. Within the Accounting Services-Navy, functional responsibilities have been assigned as identified in Appendix 1 of DFAS 5010.38-R. The Business

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Management Office, DFAS-ADB/CL, with the designation of a FMFIA Coordinator, has primary responsibility for administering the MC Program within Accounting Services -Navy.

3.2. The DFAS Cleveland Director implements a comprehensive system for internal management controls, assigning responsibilities and reviewing and approving decisions related to the MC Program. This includes review and approval of the Annual Statement of Assurance (ASA) and the materiality of management control weaknesses.

\*3.3. In addition to the Accounting Services-Navy FMFIA Coordinator (hereafter referred to as the FMFIA Coordinator), a structure of MC participants with specific duties and responsibilities must be established and maintained throughout Accounting Services-Navy. These individuals include senior management officials, site specific FMFIA POCs, management control support teams (individuals assigned FMFIA support responsibilities at the Field Sites) and AU managers. All play a vital role in executing the MC Program.

3.4. The FMFIA Coordinator and support POCs at each site are responsible for maintaining specific AU/MC data. Managers are responsible for keeping the MC data current, accurate, and reliable, including documentation to support MCE evaluation results. They are also responsible for ensuring documentation is readily available to support correction of deficiencies reported in nonmaterial or material weakness reports or as a result of audit findings. Annually, the MC Managers will sign the AU certification statement(s) and forward them for approval through their FMFIA POC(s) to the on-site Accounting Director. The FMFIA POC(s) will then forward the certification statements to the FMFIA Coordinator at DFAS Cleveland. The FMFIA POCs will ensure that Site Directors are briefed on the results of the annual MCEs and the adequacy of management controls.

3.5. Electronic mail and Word Processing System copies of specific MC Program data ensure reliable records maintenance and improve reporting response time. AU managers, as well as FMFIA POCs, shall maintain electronic copies of input to data calls and use them for record-keeping purposes. These files should have "as of" dates for rapid reference. Record-keeping files should include previous submissions of the MCE matrices/evaluations, weakness reporting, certification forms, ASA input and AU descriptions.

\*3.6. MC Managers will identify appropriate corrective actions and target dates for all material and non-material weaknesses. They will assure all weaknesses are reported and milestones are tracked until the deficiencies are corrected. All weaknesses will have corrective actions validated and will be certified closed by the Field Site Director and approved by the DFAS Cleveland Business Management Office, the DFAS-CL Accounting Director and the DFAS-CL Site Director or Deputy Director.

3.7. Through continuous monitoring and periodic evaluation, MC Managers will verify the effectiveness of their management controls within each AU. The results of these periodic evaluations will be documented and maintained. This will be done quarterly at a minimum. The evaluations will then be used as supporting documentation for the annual MCE certification.

\*4. **REFERENCES** All references are available at the DFAS ePortal under the Plans & Strategy Community/FMFIA/FMFIA Links.

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- 4.1 Federal Managers' Financial Integrity Act of 1982 (P.L. 97-255)
- 4.2 DFAS 5010.38-R, Federal Managers' Financial Integrity Act -Section 2- Management Control Program
- 4.3 DoD Instruction 5010.40, Management Control (MC) Program Procedures
- 4.4 OMB Circular A-123, Management Accountability and Control
- 4.5 GAO Standards for Internal Control in the Federal Government
- 4.6 DoD Directive 5010.38, Management Control (MC) Program

**5. TERMINOLOGY**

- 5.1. ABL Accounting Business Line
- 5.2. ASA Annual Statement of Assurance
- 5.3. AU Assessable Unit
- 5.4. DoDIG Department of Defense Inspector General
- 5.5. FMFIA Federal Managers' Financial Integrity Act
- 5.6. GAO General Accounting Office
- 5.7. MC Management Control
- 5.8. MCE Management Control Evaluation
- 5.9. MCP Management Control Program
- 5.10. NAS Naval Audit Service
- 5.11. OMB Office of Management and Budget
- 5.12. OPR Office of Primary Responsibility
- 5.13. OUSD(C) Office of the Under Secretary of Defense, Comptroller
- 5.14. POC Point of Contact
- 5.15. RA Risk Assessment

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**6. SYSTEMS**

N/A

**7. PROCEDURE****\*7.1. Accounting Services-Navy Responsibilities When Organizing the MC Process.**

7.1.1. The process includes assigning responsibilities, providing personnel for planning, directing, and implementing the MC Program; developing reporting and tracking capabilities; ensuring continuous monitoring and periodic evaluations of MCs; and maintaining appropriate documentation.

7.1.2. All WORD documents used in responding to data calls shall be in Times New Roman Font 12 unless otherwise stipulated by the FMFIA Coordinator.

7.1.3. Tracking tools provided by the FMFIA Coordinator must be maintained in the same format when used for responding to data calls and updating information. This includes the AU Listing, the MCE Matrix, Nonmaterial and Material Weakness Report formats, the Weakness Tracking spreadsheet and any other tools created for MC Program monitoring and reporting purposes.

**7.2. Segmenting Assessable Units.**

7.2.1. The Accounting Services-Navy MCP requires the use of an assessable unit model to evaluate organizational risks. Network managers establish AUs by segmenting the site(s) into proper subdivisions of work suitable for evaluation.

7.2.2. Managers must ensure that all major functions and activities they have oversight of, and all management controls associated with those functions and activities, are included in one or more appropriately segmented AUs.

7.2.3. Once an AU title is established, that exact same title will be used on all documentation referencing the AU, e.g., the AU MCE: *10.A.01.00.001 ADP Security*, or the AU Listing, *10.A.01.00.001 ADP Security*.

\*7.2.4. As new AUs are established, a number must be assigned. Requests for new AU numbers will be sent to the site FMFIA POC who will forward them to the FMFIA Coordinator at DFAS-CL. The FMFIA Coordinator will request assignment of AU numbers from the DFAS Accounting Business Line (ABL) FMFIA Coordinator.

7.2.5. Included in the AU listing will be a designator of risk associated with each assessable unit (high, medium, or low). The risk assessment (RA) is a self-assessment based upon the MC manager's knowledge, analysis, and testing of the operational performance and capability of internal management controls within his/her assigned assessable unit(s). The RAs are performed to determine an assessable unit's vulnerability to waste, fraud, loss, abuse, mismanagement, and misappropriation.

7.2.6. Each Field Site/Central Site office will maintain an up-to-date listing of AUs (Illustration 9.1).

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Quarterly submission of AU listings must be provided to the FMFIA Coordinator on or before the quarterly due date established by the FMFIA Coordinator. The AU listing will include an “as of” date in the page “footer.” Material or nonmaterial weaknesses associated with an AU will be identified by title and number and listed in the AU description block immediately following the AU description. Changes requiring identification include additions or deletions of major functions, changes in management, office codes, phone numbers, MCE scheduling, weakness association, or risk rating. Justification must be provided for the addition or deletion of an AU, for changes to the MCE schedule, or for adjustments to risk ratings. The Site Director must approve these changes. The Site Director endorsing an email being sent to the FMFIA Coordinator can do this. A copy of the revised AU listing must be attached to the e-mail message.

7.2.7. MC Managers must ensure all major functions and activities are covered by an assessable unit as a result of reorganizations or realignment of functions. Reorganizations within a site must be clearly identified in an updated AU listing. When the realignment of functions involves another site, a list must be provided to the FMFIA Coordinator at the time of the transfer identifying the following:

- (a) the AU number(s) at the current site that is (are) transferring the functions.
- (b) the title of the functions being transferred, and
- (c) the name of the site receiving the transferred functions.

7.2.8. Deleted AUs will be identified at the bottom of the AU listing in **bold** type. Information on deleted/superseded AUs will be maintained for two (2) years (see the Retention Guidelines, Illustration 9.11)

### 7.3. Documenting Current Data Elements and Certification of Management Controls.

\*7.3.1. As a normal course of business, MCs are developed, modified, or deleted as mission and responsibilities change. Properly completing and updating these MC data elements and validating their effectiveness constitutes continuous monitoring and periodic evaluation. Evaluation of vital MCs will be scheduled, performed, and documented as necessary to support that the subject MCs are working effectively. Vital controls are most important to the accomplishment of the organization’s mission or responsibilities. All vital MCs will be evaluated at a minimum, quarterly. Some MCs may be classified as “non-vital” because minor non-compliance does not have a significant impact on accomplishment of the mission or responsibilities of the assessable unit. Classification of MC’s as vital or non-vital is a management decision. A manager may list all MCs in the MCE but must designate which controls are “vital.”

7.3.2. MCs are documented using the Management Control Evaluation (MCE) format. Although DFAS 5010.38-R provides an example of the Matrix to Match Goals/Risks/Controls (Appendix 3) and the Testing Matrix for Management Controls (Appendix 4), the Accounting Services-Navy will use the single page MC Assessment and Testing Matrix (Illustration 9.2).

- All columns in the matrix must be completed.
- All fields designated in the header/footer must be completed. These include: (a) AU Title, (b) AU Number, (c) Site Name/Code, (d) AU Manager, (e) Major Function Description, (f) file name, and (g) “as of” date.

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- All acronyms must be spelled out the first time that they are used, or a listing of acronyms may be attached to the MCE for reference.

7.3.3. An evaluation frequency indicates how frequently that the normal test of the management controls is documented. The frequency can be daily, weekly, monthly or quarterly. Generally, an interval of quarterly is acceptable for MCE purposes. Several factors could influence the periodic evaluation frequency selected. For example, a vital control should be evaluated more frequently if there is a higher risk associated with the function; more frequent past problems have occurred; or if there is a greater management interest or concern in the area.

7.3.4. The results of the testing must be documented at the evaluation frequency selected. The evaluations are to be recorded on an evaluation checklist. The checklist may be represented by the MCE format. In the "Evaluation Results" column, the date of each test evaluation and the name of the reviewer must be identified. The evaluation documentation will include the actual test results and an explanation of the effectiveness of the management controls.

7.3.5. All MCEs must have a mandatory quarterly requirement to review and evaluate management controls governing all system access and to validate each access is required at the appropriate level.

\*7.3.6. The evaluation results indicate the conclusion of the examination of the vital controls. The steps taken to validate the accuracy of the controls must be described. More than one procedure can be used to evaluate a vital management control. The use of metrics in describing the results is requested when applicable. Using such terms as "successful" or "met" will not be considered adequate documentation. If a vital control is not working effectively, a weakness report must be prepared (See 9.5). If there is already a weakness associated with the AU, it should be identified, along with current status. Also, if the AU has been involved in recent audits (e.g., DoDIG, GAO, NAS, Internal Review, external Audit Firms), reference should be made to them. The AU manager and the Site FMFIA POC must review all documentation for accuracy and completeness. Documentation that is not complete or properly identified must be returned for rework. If the FMFIA Coordinator does not receive confirmation that MCEs are completed in a timely matter, the due date for that data call will be given a "not met" rating on the Report Card tracking tool (the Report Card is explained in paragraph 7.7).

\*7.3.7. Copies of MCEs will no longer be required to be forwarded to the FMFIA Coordinator. Hardcopies of all MCEs and flowcharts will be maintained on-site. Guidance from DFAS Arlington indicates a new requirement that MCEs are to be uploaded to the DFAS FMFIA ePortal Project. To prevent duplication of effort, each site will be allowed access to this project and be required annually to upload copies of each completed MCE into the appropriate folder. A file must be maintained for supporting documentation and work papers associated with each MCE completed. The responsible site must maintain these files. The Retention of documentation shall be at least 2 years.

\*7.3.8. Flowcharts must be completed for major functions/processes, identifying at a minimum, vital management controls and their locations in the process. Flowcharts will be maintained in a current status and reviewed at least annually for correctness. The flowcharts will identify the major processes and management controls within each AU. All flowcharts must identify the process, the AU number, the site, and have an "as

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of” date. A current flowchart must accompany each MCE if applicable. Administrative AUs not directly involved in accounting processes are exempt from maintaining flowcharts.

\*7.3.9. Each MCE must have a certification statement to validate annual certification of management controls. Although it is no longer a requirement to forward the MCEs and flowcharts to the FMFIA Coordinator, the certification forms must be forwarded to provide confirmation that the MCEs are completed as scheduled and to support certification of the Annual Statement of Assurance (ASA). The certification forms may be scanned and sent via email, or faxed directly to the FMFIA Coordinator at DFAS Cleveland using Right Fax. The certification format can be found in DFAS 5010.38-R, Appendix 2. Each certification form should have the name of the individuals typed next to or beneath each signature (Illustration 9.3). Persons that are required to sign the certification form include:

- (a) The person that performed the evaluation (if other than the AU manager).
- (b) The AU manager.
- (c) The 2<sup>nd</sup> level manager to whom the AU manager reports.
- (d) The Accounting Director.

It is at the discretion of the Site Director whether his/her signature is required prior to submission of the MCE to DFAS/AJI/CL. However, the Site Director must be aware of the MCE results prior to release to DFAS-CL.

7.3.10. The manager’s annual certification of the adequacy of management controls is required to certify that the MC data elements are complete and updated, that all scheduled evaluation requirements were satisfactorily completed, and that all weaknesses and corrective actions have been identified. The AU manager has ultimate responsibility for the overall accuracy and reliability of evaluation documentation and preparation of any accompanying flowcharts. Although the evaluation can be a shared effort, the role of other persons assigned to assist in the review is limited to a support capacity. A policy memorandum was issued on June 5, 2002, SUBJECT: Clarification of DFAS Cleveland Management Control Evaluation (MCE) Policy and Procedures (Illustration 9.4).

\*7.3.11. At any time during the FY quarter that an MCE is scheduled, but not exceeding the Report Card due date, it can be completed and forwarded to the on-site FMFIA Point of Contact. The MCE package must include:

- (a) MCE matrix,
- (b) Certification Form
- (c) Evaluation Checklist (each evaluation must be dated and the name of the evaluator identified. The site FMFIA POC will maintain the [signed] original checklist),
- (d) Weakness report(s) as applicable, and
- (e) Flowcharts (reference paragraph 7.3.8).

Additional documentation may be provided if it is determined as necessary to support the evaluation results. Include the AU number in each file name. Ensure all attachments have an “as of” date.

\*7.3.12. If a weakness is identified during an AU evaluation of management controls, a copy of the weakness report must be forwarded to the FMFIA Coordinator as soon as it is reported and approved by management. Previously reported weaknesses will be updated on a quarterly basis. However, if there is a previously reported open weakness associated with the assessable unit under review, a status comment will be required as part of the MCE evaluation documentation.



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\*7.3.13. If the AU has been involved in any external audit agency or Internal Review audit within the last year, the audit will be referenced in the MCE. If a material weakness has been reported, the title of the weakness report must be identified.

\*7.3.14. Alternate MCE Reporting: In lieu of using the MCE matrix form (Illustration 9.2), the DFAS Denver Management Control Tracking System is now available for use by each site. The database is authorized for use and can be installed on the local Share Drive and used by designated individuals. The multi-purpose database includes an FMFIA section that can be used for MCE and weakness reporting and tracking. Files can be downloaded to WORD documents and printed to facilitate distribution and reporting requirements. The database is an effective and efficient tool for recording periodic evaluations and maintaining readily available MCE documentation.

7.4. The Annual Statement of Assurance (ASA).

7.4.1 The FMFIA Coordinator will issue instructions on the preparations of the ASA. Every site is to follow the same format and reporting criteria.

7.4.2. ASA reports from each Field Site and Central Site office will be consolidated into an Accounting Services-Navy ASA in accordance with the instructions issued by the MC Program Manager, DFAS Arlington. The ASA will be reviewed, approved and signed by the Director, Accounting Services-Navy.

7.4.3. Material Weaknesses are included in the ASA. All weakness reports must be up-to-date and approved by the DFAS Cleveland Accounting Director. Closed milestones and all closed weaknesses are required to have certification documentation.

7.3. Quality Assurance Procedures.

7.5.1. The FMFIA Coordinator will implement quality assurance (QA) procedures to ensure the accuracy, completeness, and reliability of MC data. QA procedures will cover the review of MC data input and maintenance. Training needs shall be assessed periodically and support provided as necessary.

\*7.5.2. The FMFIA POC at each site is required to maintain files or have access to files that contain pertinent FMFIA documentation. This includes historical and current files containing the following:

- Individual AU files
- AU listings,
- Completed MCEs,
- Signed Certification Forms for completed MCEs,
- Up-to-date Flowcharts,
- Weakness tracking (includes open and closed weakness reports)
- Signed Certifications for MC weakness/milestone closures
- Mid-Year Evaluations of Material Weaknesses reported by other sites,
- Audit follow-up documentation
- Approvals for audit closures
- ASA Reports
- Supporting documentation for completed MCEs (preferably maintained by AU Managers.)

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\*7.4.3. An appropriate tracking tool will be designated and required for proper data management. Reference 7.3.14. The DFAS Denver Management Control Tracking System is authorized for use by Accounting Services-Navy.

\*7.5.4. MC Program Reviews will be performed annually by designated FMFIA support staff. Results of the reviews will be provided to the Site Directors. Electronic copies of reviews will be made available upon request to audit personnel. Internal requests for copies of MCEs may be obtained from the FMFIA POCs.

7.6. Management Control Weaknesses.

7.6.1. All MC weaknesses must be reported, tracked and monitored until they are satisfactorily validated and certified as fully corrected. The MC manager or the next higher level manager is usually the first person to identify a weakness as material. Executive level management makes the final determination of materiality.

\*7.6.2. MC Managers are required to prepare a weakness report following the guidance in DFAS 5010.38-R, Appendix 5, and using the amended format as shown in Illustration 9.5 of this SOP. If a weakness is determined to be material, the required format is represented in Illustration 9.6. Criteria for determining a material weakness are listed in Illustration 9.7. To assist in analyzing potential materiality of findings identified in audits, the Accounting Services-Navy has implemented the use of the FMFIA Materiality Analysis Form (Illustration 9.7.a). This analysis will encompass audits directed specifically at DFAS Cleveland and sites within the Navy Accounting Business Line (NABL) as well as audits performed within other Accounting Business Lines that identify conditions that could be of potential risk within Accounting Services-Navy. The same scrutiny will be applied to potential material weaknesses identified as a result of an MCE or by a management discovery during normal operations. Since determination of materiality is a management judgment, we request management use the form to perform a self-assessment of the identified deficiencies and determine their impact on operations. A statement must be provided to (a) recognize the existence of a material weakness, or (b) to provide clear justification supporting the conclusion that management controls provide reasonable assurance that the objectives of the MC Program are being met and that the risks are manageable. Overall efforts to use this form at the time a condition/finding is identified will minimize the risk of non-compliance with the FMFIA requirements to report material weaknesses. This process will serve to strengthen the NABL material control evaluation effort – a key component of achieving an unqualified audit opinion.

7.6.3. Correction of Material Management Control Weaknesses. Material Management Control Weaknesses will be reported in the ASA and will be tracked and updated quarterly using the format shown in Illustration 9.6. MC Managers are responsible for ensuring the adequacy of identified corrective actions, the completion of each milestone target date and for thoroughly documenting and providing adequate justification of a slippage (for either milestones or the overall target date of the weakness).

\*7.6.4. Closure of a material weakness is coordinated through Accounting Services-Navy for approval. The Field Site Director must sign the certification form and forward it to the Business Management Office FMFIA Coordinator for processing. If the weakness to be closed originates in the DFAS-CL Accounting Office, it will be certified closed by the immediate Director and then forwarded to the Accounting FMFIA POC for processing through the Director of Accounting to the Business Management Office. Final approval will be

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obtained from the DFAS-CL Director or Deputy Director. A copy of the closed weakness and a certification statement (Illustration 9.8) must be provided when closure approval is requested.

7.6.5. The validation and certification of individual milestones for a material weakness are requirements for quarterly reporting. The procedure for milestone closure certification remains the same as in paragraph 7.6.4 above. See Illustration 9.9.

7.6.6. Correction of Nonmaterial Management Control Weaknesses. Nonmaterial Management Control Weaknesses will be tracked and updated quarterly using the format shown in Illustration 9.5. MC Managers are responsible for ensuring the adequacy of corrective actions identified, the completion of milestone target dates, and for providing a justification for slippage of the weakness or milestone target date(s). Closure of a nonmaterial weakness is coordinated through the Business Line for approval using the same procedure as in 7.6.4 above.

\*7.6.7. An electronic copy of a weakness report requires a linking title to the AU identifying the weakness. The file name must include the date of the update, the AU number, and if possible, a brief title of the weakness (e.g., Jun03-12A01SD001DWCFWK.doc).

7.7. The Report Card.

7.7.1. To ensure that MCs are in place and working satisfactorily and that program evaluation and reporting requirements are being met, a quarterly reporting tool is used to provide periodic updates to upper management. The tool used is the DFAS-CL Report Card (Illustration 9.10).

\*7.7.2. The Report Card is used to monitor the reporting of data calls as well as to ensure established quarterly and biannual Directors' reporting requirements are met. In order to receive a "met" designation, a data call must be received on or before the due date and must contain accurate and sufficient data to meet data call requirements. If documentation is received for a specific data call but requires rework, the item will still receive a "met" if corrections are received by the established due date or an agreed upon revised due date. The Director or Deputy Director of the site must approve the Report Card submission. This can be done via e-mail. An example of the format to use for submitting data for standard quarterly and bi-annual reporting of specific Director actions can be found in Illustration 9.10.a. The Report Card is reviewed quarterly by the Cleveland Director.

## **8. POINTS OF CONTACT**

\*8.1. DFAS-CL: Sharon Ricci, FMFA Coordinator: (216) 204-7002, Right Fax (216) 204-1916 or [sharon.ricci@dfas.mil](mailto:sharon.ricci@dfas.mil)  
Hank Laurent, Director, Business Management Office: (216) 204-7100 or [hank.laurent@dfas.mil](mailto:hank.laurent@dfas.mil)

## **9. ILLUSTRATIONS**

Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines

SOP NO. 7310.126

EFFECTIVE DATE: 10/19/04

- 9.1. Assessable Unit Listing
- 9.2. MC Assessment and Testing Matrix
- 9.3. MCE Certification Format
- 9.4. Memorandum, SUBJECT: Clarification of DFAS Cleveland Management Control Evaluation (MCE) Policy and Procedures
- 9.5. Uncorrected Management Control Weakness Report
- 9.6. Uncorrected ABL Material Weakness Report
- 9.7. Definition and Criteria for Material Weakness
- 9.7.a. FMFIA Materiality Form
- 9.8. DFAS Weakness Closure Certification
- 9.9. DFAS Weakness Milestone Certification
- 9.10. Report Card
- 9.10.a. Example format for quarterly/bi-annual Director reporting.
- 9.11. Retention Guidelines

Contact Ms. Sharon Ricci, DFAS-ADB/CL, 216-204-7002 for a copy of Illustrations 9.1 and 9.2.

Illustration 9.1

Illustration 9.2

May 2002  
DFAS 5010.38-R

**MANAGEMENT CONTROL REVIEW GUIDE**  
**ASSESSABLE UNIT SUMMARY AND CERTIFICATION STATEMENT**

Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines

SOP NO. 7310.126

EFFECTIVE DATE: 10/19/04

Assessable Unit Title: \_\_\_\_\_

Assessable Unit Number: \_\_\_\_\_

Organization Code: \_\_\_\_\_

Brief Narrative Description of what is covered under Assessable Unit:

\_\_\_\_\_

\_\_\_\_\_

**Manager's Certification Statement**

I have evaluated the system of internal management accounting, financial, and administration control in effect as of \_\_\_\_\_ as performed per DFAS policy and DoD Guidance. Except for identified weaknesses (if applicable), the system of vital management controls in effect during this period provided reasonable assurance for this assessable unit that the objectives of the Federal Managers' Financial Integrity Act (FMFIA) (reference (d)) are met and that:

1. Obligations and costs comply with applicable laws.
2. Assets are safeguarded against waste, loss, unauthorized use, and misappropriation.
3. Revenues and expenditures applicable to Department of Defense (DoD) operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports, and to maintain accountability over the agency assets.
4. Program, administrative, and operating functions are efficiently and effectively carried out in accordance with applicable law and management policy.
5. Waste, fraud, and mismanagement are prevented.
6. Timely corrections of MC weaknesses are accomplished.

Furthermore, I attest that I have followed all procedures and processes required under the DFAS MC Program and that:

1. All MC Matrix, required under Appendix 3 of DFAS 5010.38-R, are in a complete, accurate, and current condition.

**Illustration 9.3**

2. All required evaluations of vital MCs have been completed as scheduled and required; and documentation is available for review.
3. All management control weaknesses and corrective actions have been reported and updated under the MC Program.

Evaluation Performed by: \_\_\_\_\_ signature \_\_\_\_\_, Date: \_\_\_\_\_  
 (type/print name) \_\_\_\_\_

Evaluation Approved by: \_\_\_\_\_ signature \_\_\_\_\_, Date: \_\_\_\_\_

<b>Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines</b>	<b>SOP NO. 7310.126</b>
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Evaluation Approved by: (type/print name) \_\_\_\_\_  
signature \_\_\_\_\_ Date: \_\_\_\_\_  
(type/print name) \_\_\_\_\_

Illustration 9.3 (con't.)

**Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines****SOP NO. 7310.126****EFFECTIVE DATE: 10/19/04**

DFAS-CL/AJI)

June 5, 2002

## MEMORANDUM FOR DISTRIBUTION

SUBJECT: Clarification of DFAS Cleveland Management Control Evaluation (MCE) Policy and Procedures

We have reviewed the DFAS Arlington requirement to perform continuous Management Control Evaluations (MCE) and provide yearly certification (reference DFAS 5010.38-R). Taking into consideration current techniques identified by the Field Sites, DFAS Cleveland is clarifying its position on the procedures that will be allowed for completion of these evaluations. The following people in the capacities identified may perform the MCEs:

1. The manager of the Assessable Unit (AU) and/or a designated representative within that assessable unit.
2. A shared effort between a designated on site Accounting Business Line (ABL) review team, and the manager of the assessable unit. In this instance, a person or persons not associated with the specific AU, but belonging to a special on-site ABL review team, may assist the AU manager in preparation of the MCE matrices and flowcharts, and perform the testing of the identified internal controls. Their role is limited to a support capacity. The AU manager has ultimate responsibility for the overall accuracy and reliability of evaluation documentation and preparation of any accompanying flowcharts. The AU manager must ensure identification of all vital management controls and share any concerns he/she may feel need specific attention, including any current audit findings or weaknesses associated with the AU under review. Once the manager has established the criteria for review, the ABL review team may proceed with the evaluation process. If a weakness report is prepared as a result of the evaluation, the manager must assist in its preparation and approve the final report.
3. All MCEs must be reviewed and approved by the managers of the AUs as well as the Accounting Director at each site. It will be left to the discretion of each Site Director to determine if he/she requires reviewing and approving the MCEs prior to their release to DFAS Cleveland. The managers' signed certifications of completed evaluations/weakness reports will be considered as support to each Site Director's Annual Statement of Assurance certification.

The FMFIA Program represents our compliance with Public Law 97-255. It is a major support in the certification of adequate internal controls when the DFAS Cleveland Director signs the Annual Statement of Assurance. We must support this program and ensure everyone understands its importance. If the continuous evaluations and maintenance of assessable units are done properly, our overall efforts will minimize the daily

Illustration 9.4

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**Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines****SOP NO. 7310.126****EFFECTIVE DATE: 10/19/04**

risks we face and the potential for audit findings, fraud, waste, abuse and mismanagement, not to mention adverse Congressional and public opinion.

Questions may be directed to Ms. Sharon Ricci, commercial (216) 204-7002, or Mr. Stan Koch, commercial (216) 204-7066.

//signed//

Kenneth R. Sweitzer  
Deputy Director

Distribution:

DFAS-CL Field Organizations

DFAS-AA

DFAS-AJS

DFAS-AJI

Illustration 9.4 (con't.)

Reference: DFAS 5010.38-R, AP5



Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines

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**UNCORRECTED MANAGEMENT CONTROL WEAKNESS REPORT**

Check one of the following to indicated whether weakness is or is not material:

Material \_\_\_\_\_ Nonmaterial \_\_\_\_\_

Also, answer the following questions regarding whether this weakness has been Previously reported:

Has this weakness previously been reported? (Yes or No) \_\_\_\_\_. If previously reported, in what FY? \_\_\_\_\_.

If previously reported, was weakness closed? (Yes or No) \_\_\_\_\_. If previously closed, in what FY? \_\_\_\_\_.

If previously reported, is weakness currently open? (Yes or No) \_\_\_\_\_.

(If a weakness is currently open and being reported, identify the exact title of the weakness in the MCE "Evaluation Results" and comment on current status.)

1. **Title and Description of Material Weakness:** Provide a title of 10 words or less.  
Describe nature of weakness.
2. **Functional Category:** Comptroller/Resource Management  
(Include Assessable Unit number here)
3. **Current Target Correction Date:** If the target date cannot be met, provide a new target date. Provide a justification for the change in closure date in the next block, "Reason for Change in Date(s)."
4. **Reason for Change in Date(s):**
5. **Component/Appropriation/Account Number:**
6. **Validation Process:**
7. **Results Indicators:**
8. **Source(s) Identifying Weakness:**
9. **Major Milestones in Corrective Action:** (include a POC with each milestone update unless the weakness POC is the same person updating each milestone)

A. Completed Milestones:

If any milestone date must be changed, provide a justification and a new date in your update.

If a weakness is closed, provide a certification memo signed by your site Director.

Illustration 9.5

Date:

Milestone:

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C If milestone is completed, place a “C” under the date column. Write the milestone under the milestone column and then place the “closed or completed” date after the milestone. Include a POC. Type your updates/changes in **bold**.

(Example)

C **Technicians received training. (Completed 12/02 or 12/20/02.)**  
**POC: John Doe, Code AB**

B. Planned Milestones (This Fiscal Year):

Date: Milestones:

(Examples)

**06/03** Technicians receive training.  
**Update March 03: Did not meet due date of 03/03 due to scheduling problems. Training has been rescheduled for June 10-11, 2003. (POC: John Doe, Code AB)**

06/03 Update Desk Procedures.

09/03 Hold conference with customer to establish new POA&M.

C. Planned Milestones (Beyond This Fiscal Year):

Date: Milestone:

**12/03 Validation of corrective actions.**  
**THIS IS YOUR LAST MILESTONE!**  
**It must match the Fiscal Year (FY) of the weakness target date in block #3.**

10. **Status of Participating Functional Office or Organization:**

Example:

DFAS Cleveland (I) = Internal to DFAS Assured  
 Department of the Navy (X) = External to DFAS Assured

11. **Point of Contact:** Name/Office Code/Site/Phone.

Illustration 9.5 (con't.)

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**\*UNCORRECTED ACCOUNTING MATERIAL WEAKNESS****A SUMMARY PRESENTATION****Identified During Prior Period (or "Current " Period)****Tab B-2**

**Title and Description of Material Weakness:** Provide a brief title of 10 words or less. If the weakness was reported in a prior year and has an OUSD(C) tracking number, place it parenthetically following the title (example: *Controlling Problem Disbursements* (99-041). Explain the nature of the weakness and why it is considered material.

**Functional Category:** Comptroller/Resource Management  
**Include Assessable Unit number here.**

**Pace of Corrective Action:**

**Year Identified:**

**Original Targeted Correction Date:**

**Targeted Correction Date in Last Year's Report:**

**Current Target Date:**

**Reason For Change in Date(s):** If target date cannot be met, a justification must be provided.

**Component/Appropriation/Account Number:** Material weaknesses must identify the funds budgeted (by fiscal year, appropriation and amount, including an estimated cost-to-complete) to correct each systemic and uncorrected material weakness reported in the Annual Statement of Assurance. This is an OUSD requirement.

<b><u>Title</u></b>	<b><u>Appropriation</u></b>	<b><u>FY200X</u></b>	<b><u>FY 200X</u></b>	<b><u>FY 200X</u></b>	<b><u>Cost to Complete</u></b>	<b><u>Total</u></b>
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**Validation Process:**

**Results Indicators:**

**Source(s) Identifying Weakness:** When audit findings are the source of the weakness identification, identify the title, number and date of the document in which the weakness was identified. If the weakness was identified by more than one source, list all identifying sources in order of significance. Dates should be written civilian style (i.e., December 31, 2003), not military style (i.e. 31 December 2003). Do not abbreviate the month. This is an OUSD requirement

Illustration 9.6

**Progress To Date:** Use a narrative to describe significant accomplishments or actions taken within the fiscal

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year to correct the weakness. Use of short descriptions in bullet style is preferred. This is an OUSD requirement.

**Major Milestones in Corrective Action:**

**A. Completed Milestones:**

<b><u>Date:</u></b>	<b><u>Milestone:</u></b>
C	If milestone is completed, place a "C" under the date column. Write the milestone under the milestone column and then place the "closed or completed" date after the milestone.
(Example)	
C	Technicians received training. (completed 12/ 02 or 12/20/02) POC: John Doe, Code AB

**B. Planned Milestones (This or Next Fiscal Year):**

<b><u>Date:</u></b>	<b><u>Milestone:</u></b>
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**C. Planned Milestones (Beyond This or Next FY):**

<b><u>Date:</u></b>	<b><u>Milestone:</u></b>
---------------------	--------------------------

**Status of Participating Functional Office/Organization:**

Example:

DFAS Cleveland	(I) = Internal to DFAS	Assured
Department of the Navy	(X) = External to DFAS	Assured

**Points of Contact:** Name/Office Code/Phone

Illustration 9.6 (con't.)

**DEFINITION AND CRITERIA FOR MATERIAL WEAKNESS**

**Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines****SOP NO. 7310.126****EFFECTIVE DATE: 10/19/04**

Deficiencies in management controls can be identified from various sources of information. These can include, but are not limited to, management knowledge gained from the daily operation of programs and systems; MCEs; IG and GAO reports; outcomes of hotline complaints; program evaluations; audits of financial statements conducted pursuant to the Chief Financial Officers Act, as amended; review of financial systems; and reviews of systems and applications conducted pursuant to the Computer Security Act of 1987 and OMB Circular No. A-130, "Management of Federal Information Resources", etc. The use of a source of information should take into consideration whether the process included an evaluation of management controls.

A deficiency should be reported if it is or should be of interest to the next level of management. Employees and managers should report deficiencies to the next supervisory level, which allows the chain of command structure to determine the relative importance of each deficiency.

A deficiency that is determined to be significant enough to report outside the agency shall be considered a "material weakness." The following provides criteria to assist in that determination.

1. Significantly impairs fulfillment of mission.
2. Significantly weakens safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets.
3. Violates a statutory requirement.
4. Allows fraud to go undetected.
5. Deprives the public or the component of needed services.
6. Causes significant adverse publicity for DFAS or DoD.
7. Results in a conflict of interest.
8. Involves significant adverse impact on information security.
9. Generates unreliable information causing unsound management decisions.
10. Results in potential or actual injury or death of an employee.

**Illustration 9.7**

(Condensed from Excel Form)

Site:

FMFIA Materiality Analysis Form

Date:

**Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines****SOP NO. 7310.126****EFFECTIVE DATE: 10/19/04**Type of Review: ☐ External Audit Agency ☐ Internal Review Audit ☐ Management Control Evaluation ☐ Other

Assessable Unit Number (if applicable): \_\_\_\_\_

Audit Title and Report Number (if applicable): \_\_\_\_\_

Audit Project Number (if applicable): \_\_\_\_\_

Condition/finding: \_\_\_\_\_

(Identify by number/title in audit/MCE)

A material weakness must satisfy two conditions:

Yes/No

1. Is this a condition/finding in which Management Controls (MC), or compliance with them, do not provide reasonable assurance that the objectives of the MC Program are being met? \_\_\_\_\_

*Note: Does the weakness result from MC's not in place, not used, or not adequate?*

2. Does this condition/finding require the attention of the next higher level of management? \_\_\_\_\_

**Instruction:** The following considerations must be scored as "significant or insignificant" to help a manager determine whether the absence or noncompliance with a control is a material weakness and to judge the relative impact on operations. Managers will complete this form for the Accounting Director's review and comment and Site Director approval (if applicable). If used in response to an audit, return the form with the audit response to the Audit Liaison who will provide a copy of this evaluation to the FMFIA Coordinator. If used for MCEs/other reviews, return the form directly to the FMFIA Coordinator.

**Risk**  
(Reference: DOD Instruction 5010.40, Aug. 28, 1996, E.3)

**Rating**  
S = Significant  
I = Insignificant

Actual or potential loss of resources. \_\_\_\_\_  
 Sensitivity of the resources involved. \_\_\_\_\_  
 Magnitude of funds, property, or other resources involved. \_\_\_\_\_  
 Frequency of actual and/or potential loss. \_\_\_\_\_  
 Current or probable media interest (adverse publicity). \_\_\_\_\_  
 Current or probable congressional interest (adverse publicity). \_\_\_\_\_  
 Unreliable information causing unsound management decisions. \_\_\_\_\_  
 Diminished credibility or reputation of management. \_\_\_\_\_  
 Impaired fulfillment of essential mission or operations. \_\_\_\_\_  
 Violation of statutory or regulatory requirements. \_\_\_\_\_  
 Impact on information security. \_\_\_\_\_  
 Deprived the public of needed Government services. \_\_\_\_\_

Note: Monetary value impact generally shall be considered material when the weakness has caused or might cause loss of control over a significant amount of resources for which an organization is responsible (including money, personnel, equipment, etc.)

The determination that a condition/finding meets the criteria discussed in DODI 5010.40, Enclosure 3, Aug. 28, 1996, is a management judgement. A higher or lower dollar threshold may be applicable in different contexts, depending on the nature and characteristics of the weakness, and the level in the organization that the problem is identified.

In the appropriate box below, clearly state your determination of materiality (e.g., "Yes, I have identified a material weakness and will prepare a report," or, "No, I do not believe a material weakness exists and this is why..."). If you answer no, you must provide a clear justification supporting your conclusion that management controls provide reasonable assurance that the objectives of the MC Program are being met and that the risks are manageable.

Manager Comments/Signature/Date: \_\_\_\_\_

Accounting Director Comments/Signature/Date: \_\_\_\_\_

Site Director Comments/Signature/Date: \_\_\_\_\_

FMFIA Materiality Analysis Form  
DFAS-ADB/CL, Revised August 2004

\*Illustration 9.7.a.

**DFAS Weakness Closure Certification**

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“My staff has reviewed the attached (nonmaterial/material) weakness, (title). I certify that the corrective actions identified below have been tested and validated to confirm that the controls are operating as intended and that the weakness is closed.”

Signature Block of Director

**Weakness Report Title.**

**Brief Summary of Weakness Description.**

**Date of Closure.**

**Validation Process.**

**Action Taken.** (clearly describe how corrective action was tested and validated to justify closure. Provide metrics where possible).

**Point(s) of Contact.**

Illustration 9.8

**DFAS Weakness Milestone Closure Certification  
(Example)**

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“My staff has reviewed the attached material weakness, *Accounts Receivable (A/R) Non-Compliance (ARNC-1)*. I certify that the corrective actions identified below have been tested and validated to confirm that the controls are operating as intended and that the milestone(s) for corrective action can be closed.”

Signature Block of Director

**Weakness Report Title.** Accounts Receivable (A/R) Non-Compliance (ARNC-1).

**Brief Summary of Weakness Description.** This weakness is related to Accounts Receivable problems and non-compliance for the Public, Government, General and Working Capital Funds for all DFAS-CL Departmental Reporting and Field Sites.

**Date of Closure for Milestone (s).**

**Validation Process** (*if more than one milestone is closed, cite each milestone and validation procedure, if different*).

**Action Taken** (*clearly describe how corrective action was tested and validated to justify closure*).

**Point(s) of Contact/site/phone.**

Illustration 9.9



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DFAS-CL  
FMFIA  
Report Card

Contact Ms. Sharon Ricci, DFAS-ADB/CL, 216-204-7002 for a copy of Illustration 9.10.

\*Illustration 9.10

Report Card  
Quarterly and Bi-Annual Action Items  
Reporting Requirements

## Accounting Services-Navy, Management Control Program (MCP) Procedures and Guidelines

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*The response to Action Items in the Report Card must identify release approval of the Director/Deputy Director (D/DD) of the site. The response may be sent via email directly from or through the D/DD to the FMFIA Coordinator at DFAS Cleveland. Most of the action items have specific instructions and reporting formats included. However, for the quarterly and bi-annual reporting actions involving direct involvement of the Directors, the formats described below may be used:*

Examples:

**Action Item (Quarterly) - Directors personally validate that an appropriate number of transactions are tested in the current quarter to ensure that each element of the total internal control schema is working as intended:**

- Submit response here explaining what was reviewed and validated to ensure compliance with applicable policies and procedures. Include results of the review (e.g., reduced abnormal balances within the accounting system by prevalidating payments to ensure valid obligations are recorded within the accounting system to eliminate NULOS and UMDs; thereby improving the accuracy of month end reports, etc).

**Action Item (Quarterly) - Directors ensure tracking system updated and receive briefings on outstanding process weaknesses and Internal Review findings:**

Submit response to support assurance that all tracking systems were in place and available to support the results of monthly reviews. Include any improvements made, such as new procedures implemented or involvement in work groups (e.g., implemented 21-day accelerated reporting to ensure the timely receipt of month end reports for Center-level and Treasury Reporting). Identify any audit reports or reviews examined to determine compliance with current laws and regulations, policies and directives to improve accounting functions through problem identification and resolution. Identify any new weaknesses.

**Action Item (Bi-annual, March/September) – Directors personally walk through key functional processes to identify any “reportable conditions”:**

- FMFIA POC works with Director to determine which specific area he/she wishes to review and schedule a date and time convenient for all involved.
- The FMFIA POC participates in the walkthrough, taking notes of any action items, problems identified, etc. Reviews should include some type of validation testing of controls in the area under review. SOPs, desk procedures and directives should be examined. Flowcharts should be reviewed to ensure they are up-to-date and that they annotate management controls. Include review of the status of any outstanding audit findings. If there are open weaknesses, review progress in meeting milestones and target date(s).
- A memo must be prepared for the Director’s signature identifying the date of the walkthrough, the area of responsibility reviewed, the evaluation methods used, and the resulting findings. The memo should be flagged if follow-up is required.

\*Illustration 9.10.a.

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**Records Retention Guidelines**  
(reference DFAS 5015.2-M)

<b><u>Document</u></b>	<b><u>Retention Period</u></b>
Assessable Units	2 years after AUs are deleted/superseded.
MCE	1 year after report of next MCE results (Minimum, 2 years).
MC Program Review	4 years after completion of the next review (includes addressing assessable unit risks).
Mid -Year Evaluation Of Material Weaknesses	1 year after completion of the next review.
Mid-Year Supporting Documents	1 year after completion of the next review.
Material Weaknesses	1 year after corrective action has been completed or after 5 years, whichever is later.
Non-Material Weaknesses	2 years after corrective action has been completed.
Annual Statement of Assurance (ASA)	Retain as permanent.
ASA Supporting Documents	Retain for 5 years. This includes letters stating compliance or noncompliance with management controls objectives as well as records describing material weakness evaluations, status of corrective actions and other similar records.
Supporting MC Documents	Same as related reports. This includes supporting documents to MCEs, MC Program Reviews, and weaknesses.
Electronic Mail and Word Processing System Copies	Maintain record-keeping files. Destroy/delete when dissemination, revision, or updating is completed, or within 180 days after the record-keeping copy has been produced.

Illustration 9.11

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## Cycle Memorandum Requirements

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In accordance with FAM Section 300, the cycle memorandum should be designed to document complete understanding of the internal control structure of the organization as it relates to a specific cycle in the financial accounting process. The cycle memorandum should sufficiently address the following areas:

1. Identify the cycle transactions, significant cycle applications, and significant financial management system.
2. Describe interfaces with other cycles.
3. Identify financial statement line items and general ledger accounts included in the cycle.
4. Include a detailed discussion of policies and procedures related to the processing of the cycle transactions to ensure that necessary actions are taken to address risks.
  - Explain how policies and procedures are communicated to employees (i.e., through policy and financial reporting manuals).
  - Describe the flow of documents through the financial system (i.e., methods and records established to record, process, summarize, and report entity transactions and maintain accountability of the related assets and liabilities). Explain how the agency:
    - initiates transactions
    - identifies and records all valid transactions
    - classifies transactions
    - measures values (including estimates)
    - explains how source documentation is used and stored
    - ensures transactions are recorded in the proper time period
    - ensures proper presentation and disclosure of transactions
    - communicates roles and responsibilities of employees
    - includes a discussion on how the computer system is utilized in the cycle (i.e., how the files are accessed, updated, deleted)
5. Describe the internal control system.
  - Discuss control objectives and their relationship to assertions (see FAM Sections 395B and 395C). Discuss how objectives are evaluated within the organization.

- Discuss performance reviews (i.e. actual vs. budget).
  - Discuss information processing (controls in place to check accuracy, completeness, and authorization of transactions) including general and application controls.
  - Describe how the agency ensures:
    - access to assets is permitted only in accordance with management’s authorization;
    - the recorded accountability for assets is compared with the existing assets at reasonable intervals, and appropriate action is taken with respect to any differences;
    - transactions are executed in accordance with management’s general or specific authorization;
    - transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements and to maintain accountability for assets.
  - Discuss physical controls (activities that ensure physical security of assets or records, periodic counts, and reconciliations).
  - Discuss segregation of duties (separate authorization, recordkeeping, and asset custody).
  - Assess the control techniques (perform walkthroughs) and follow-up.
6. Describe, in detail, any known risks and potential weaknesses and their effects on the financial statements.
- Identify control objectives designed to prevent or detect the misstatements.
7. Describe the agencies monitoring activities.
- Evaluations by internal auditors or other personnel (i.e., communication about strengths and weaknesses and recommendations for improving internal control).
  - Ongoing monitoring activities (such as supervision).
8. Recap prior audit results, including actual testing that was performed.
9. Discuss FFMIA requirements considered to this point, such as system requirements and SGL.
10. Provide flowcharts detailing the processes followed to complete a transaction. Include:
- Input and report documents
  - Processing steps
  - Files used

- Units involved
- Interfaces with other cycles

## Memorandum of Agreement

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MEMORANDUM OF AGREEMENT  
SUPPORT FOR RECORDED BOOK COST OF GENERAL PROPERTY, PLANT,  
AND EQUIPMENT ASSETS  
U.S. ARMY CORPS OF ENGINEERS, CIVIL WORKS

**Purpose.** To develop alternate methods to estimate and support the acquisition costs and capitalized improvements for real and personal property assets with remaining useful lives and administrative costs associated with land. In addition, to develop procedures for ensuring that the construction-in-progress costs that will be assigned to the assets in the future are supported.

**Auditing Guidance.** The American Institute of Certified Public Accountants Statement of Auditing Standard (SAS) Number 31, "Evidential Matter," requires that sufficient, competent evidential matter be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit. The auditor's work consists of obtaining and evaluating evidential matter concerning the assertions in financial statements. Assertions are representations by management. Management assertions regarding the valuation of assets address whether the assets have been included in the financial statements at appropriate amounts.

**Accounting Guidance.** Statement of Federal Financial Accounting Standards (SFFAS) No. 6, "Accounting for Property, Plant and Equipment," defines general property, plant, and equipment (PP&E) as any PP&E used in providing goods or services. Major categories of PP&E generally include land, land rights, buildings, other structures, construction-in-progress, capital leases, and equipment. The accounting standard requires that all general PP&E be recorded at cost. Costs should include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For general PP&E in existence before October 1, 1998 (the effective date of SFFAS No. 6), the standard allows for the use of cost estimates, if the historical cost information necessary to comply with the standard had not been maintained. In accordance with the standard, estimates shall be based on:

- cost of similar assets at the time of acquisition or
- current cost of similar assets discounted for inflation since the time of the acquisition.

DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 4, chapter 6, "Property, Plant and Equipment," August 2000, states that the dollar value assigned to an asset shall be supported by appropriate documentation. Documentation (original documents and/or hard and electronic copies of original documentation) should

be maintained in a readily available location, during the applicable retention period, to permit the validation of information pertaining to the asset, such as the acquisition cost, the acquisition date, and cost of improvements. Supporting documentation may include, but not be limited to, purchase invoices, sales and procurement contracts, Engineer Form 3013, "Work Order/Completion Report," construction contracts, work orders, and other such documentation generated independently of the entity in possession of the property. A combination of these documents is often required to validate information pertaining to the asset. Supporting documentation for land may include, but not be limited to, offers to sell, purchases, deeds, and condemnation files.

**Record Retention Requirements.** DoD Regulation 7000.14-R, "DoD Financial Management Regulation," volume 1, chapter 9, "Financial Records Retention," August 2000, states that all financial records, both paper and electronic, documenting the acquisition of DoD PP&E shall be maintained for at least the minimum period specified in the applicable General Records Schedule (GRS) issued by the National Archives and Records Administration (NARA).

**NARA Requirements for Real Property Records.** The NARA GRS No. 3, item 1 requires that records, other than abstract or certificates of title, relating to real property acquired after December 31, 1920, be retained until 10 years after unconditional sale or release of the government of conditions, restrictions, mortgages, or other liens. Records related to real property acquired prior to January 1, 1921, are not covered by the GRS and must be scheduled by submission of a SF 115 to NARA.

**NARA Requirements for Personal Property Records.** NARA GRS No. 3, item 3 requires that the routine procurement files (including contract, receipt, inspection, and payment) related to transactions (including construction contracts) other than real property that exceed \$2,000 be retained until 6 years and 3 months after final payment. Files pertaining to transactions, including construction contracts, at or below \$2,000 should be retained until 3 years after final payment.

**Army Guidance.** The Army record retention guidance is inconsistent. The Deputy Chief of Staff, Army G-4, recognizing the problem with conflicting guidance, revised Army Regulation 710-2, "Supply Policy Below the National Level," February 25, 2004, to require that source documentation for capital assets be kept by the property book office for the life of the asset. All other asset documentation is to be kept for 6 years. Engineer Regulation 37-1-29, "Financial Management of Capital Investments," November 30, 2002, requires that all capitalized asset files be maintained for 10 years after the disposal of the asset. However, Engineer Form 3013 and supporting documentation are to be maintained and disposed in accordance with Army Regulation 25-400-2, "The Army Records Information Management System (ARIMS)." The Director, U.S. Army Records Management and Declassification Agency develops ARIMS policy and procedures and administers the ARIMS program for the Deputy Chief of Staff, Army G-1. The U.S. Army Records Management and Declassification Agency's retention and disposal policy for property management refers to Army Regulation 710-2. Chapter 16 (draft),



Engineer Regulation 405-1-12, "Real Estate Handbook," states that all capitalized asset files will be retained for 6 years and 3 months after the disposal of the asset.

**Record Retention Agreement.** For real property placed in service after FY 1998, the U.S. Army Corps of Engineers (USACE) agrees to maintain all the documentation (original documents and/or hard and electronic copies of original documentation) in a readily available location for the life of the assets in accordance with NARA record retention requirements. For administrative costs associated with land acquired after FY 1998, USACE agrees that the districts must retain documentation supporting those costs in accordance with SFFAS No. 6, the DoD Financial Management Regulation, and NARA requirements. For personal property acquired after September 30, 2002, USACE agrees that the districts must follow SFFAS No. 6, the DoD Financial Management Regulation, and the NARA requirements for personal property records along with their own implementing policy.

## PART I. REAL PROPERTY

**Background.** The USACE uses several types of buildings and structures to perform its mission, such as dams, bridges, reservoirs, and locks. As of September 30, 2003, USACE reported that the acquisition value (book cost) of its general PP&E totaled \$44.3 billion. The major asset classes were buildings and other structures, \$31.1 billion; land, \$8.1 billion; construction-in-progress, \$3.8 billion; and equipment, \$1.2 billion. The DoD Financial Management Regulation requires that the owner maintain supporting documentation for assets in a readily available location during the applicable retention period. This permits the validation of information pertaining to the asset, including acquisition cost, acquisition date, and cost of improvements.

**The Problem.** The lack of documentation to substantiate the book cost of a significant portion of USACE real property assets and the administrative costs associated with land, is a major audit impediment to determining whether USACE, Civil Works, general PP&E is fairly stated. The primary reason for the unsupported costs was that USACE district offices did not maintain documentation long enough because of the conflicting guidance. In addition, for the real property amount reported on the financial statements, USACE did not have accurate subsidiary ledger information on the quantity, type, and value of buildings and other structures to support those costs.

To compensate for the lack of supporting documentation and subsidiary ledger information, USACE issued specific guidance on how the districts should estimate the acquisition cost of real property. USACE district work groups allocated the capitalized project costs, by feature of work, to each item in the real property inventory using available real estate, financial, and operations data. To the extent possible, costs associated with each feature of work were to be allocated to the individual items of real property that related to the feature. If appropriate data were not available or real estate costs did not agree with the accounting records, the work group was to use the cost data provided by the finance and accounting office and estimate the original acquisition or

construction cost of each item of real property. After assigning costs of all real property items in accordance with the accounting records, the Chairman of the Real Property Work Group or representatives of the district's Real Estate and Resource Management offices were responsible for signing an attestation statement. The attestation indicated that costs assigned to the individual items were based on actual real estate records, where available, and/or an estimated cost based on project cost/general ledger records in the Corps of Engineers Management Information System (COEMIS). Cost estimates assigned to the individual items were based on the professional judgment of the work group using the total costs reflected in each feature of work.

USACE developed procedures to ensure that the ledgers remained in balance and that the inventory data were entered into the Real Estate Management Information System (REMIS). At that time, USACE used REMIS as the subsidiary ledger. Beginning in December 1993, USACE began converting financial accounting records from COEMIS to the Corps of Engineers Financial Management System (CEFMS). USACE district offices completed the conversion of general ledger and detailed subsidiary information from COEMIS to CEFMS at different times. The last district office converted to CEFMS in March 1998. Unlike COEMIS, CEFMS accounted financially for individual real property assets by property identification code. At the time of conversion, USACE used the information from the REMIS and the COEMIS/CEFMS conversion spreadsheets to establish values for individual property identification codes and populate the general ledgers in CEFMS.

**Agreement.** All parties acknowledge that the dollar value assigned to an asset will be supported by appropriate documentation. SFFAS No. 6 and the DoD Financial Management Regulation allow the use of alternate methods to estimate and support the acquisition costs for real property assets with remaining useful lives for transactions occurring before October 1, 1998. This Memorandum of Agreement documents an agreement between the Office of the Inspector General of the Department of Defense (OIG DoD), the principal auditor for USACE, and USACE, in coordination with the General Accounting Office and the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. The agreement is an alternate method to estimate and support the acquisition costs for real property with remaining useful lives, administrative costs associated with land, and procedures for ensuring that the construction-in-progress costs that will be assigned to assets in the future are supported.

USACE agrees that SAS Number 31, "Evidential Matter," requires that the auditor consider the nature, competence, and sufficiency of evidential matter presented by management. Evidential matter supporting the financial statements consists of underlying accounting data and corroborating information available to the auditor. For evidential matter to be competent, it must be both valid and relevant. For evidential matter to be sufficient and competent, the auditor must obtain information that forms a reasonable basis for an opinion.

USACE also agrees to disclose in the notes to its Civil Works financial statements that assets put in service prior to CEFMS did not have adequate external support thus

alternate agreed upon procedures were used. USACE will include the total number of asset (to include cost) put in service before deployment of CEFMS.

**Buildings and Other Structures.** The OIG DoD agrees that the use of COEMIS/CEFMS conversion spreadsheets could be used to support the book cost of the real property (buildings and other structures) in existence before USACE converted the asset to CEFMS. Consequently, the baseline date for each asset will vary depending upon when it was converted to CEFMS. Each spreadsheet must be accompanied by an attestation statement from USACE Real Estate and Resource Management personnel that indicates that costs assigned to the individual items were based on actual real estate records, where available, and/or an estimated cost based on project cost/general ledger records in the COEMIS. In lieu of original supporting documentation indicating the acquisition date, the conversion spreadsheet or other documentation supporting the spreadsheet could be used to support the placed-in-service date established in CEFMS. USACE based the conversion procedures on the premise that the accounting records in COEMIS reflected the actual cost of the projects and would eventually serve as the basis for assigning the cost of the project to the individual property identification codes. Consequently, when the USACE completes its work on obtaining conversion spreadsheets with attestation statements for each project, the OIG DoD plans to perform other analytical procedures that would be used to determine the reasonableness of the COEMIS cost information associated with converted projects and the costs assigned to high-dollar-value assets.

For those projects for which a conversion spreadsheet is available, but an attestation statement is not provided to the auditors, USACE will obtain and provide a written statement from Real Estate and Resource Management personnel in the responsible district offices. These district personnel will attest that the costs assigned to the individual items were based on actual real estate records, where available, and/or an estimated cost based on project cost/general ledger records in the COEMIS. USACE will also furnish an attestation statement as to the reasonableness of the placed-in-service date if the conversion spreadsheet or other documentation supporting the spreadsheet does not indicate an acquisition date. If the original COEMIS/CEFMS spreadsheets are not available, USACE will re-create the spreadsheets using the same information and methodology used to create the originals. USACE will then annotate on the spreadsheets "non-original" and attest to the information and the methodology used to re-create them. If it is impossible to re-create a new spreadsheet, then USACE agrees to obtain appraisals and/or engineering estimates for missing conversion spreadsheets. A written statement describing the estimating methodology should accompany the appraisals and/or estimates and be attested to by responsible Real Estate and Resource Management personnel. USACE will clearly identify the methods/basis used to compute the estimated cost for any asset for which the conversion spreadsheet is missing. If any costs cannot be supported with documentation, USACE agrees to either reduce the book cost of the building or other structure by the amount of the unsupported costs or track the unsupported amounts by property identification code. When USACE completes the work related to the unsupported book cost, the OIG DoD agrees to consider the risk associated with relying on the unsupported amounts in auditing the financial statements.

USACE agrees that acquisition costs initially recorded in CEFMS, capitalized improvements made to existing assets since the conversion spreadsheet was prepared, and increases in acquisition costs from those recorded on the COEMIS/CEFMS conversion spreadsheets will be supported by independent source documents as prescribed in Engineer Regulation 405-1-12, chapter 16. In instances where the required documentation cannot be obtained, USACE agrees to obtain appraisals and/or engineering estimates as detailed in the DoD FMR, volume 4, chapter 6, with a written attestation. If any costs remain that cannot be supported with documentation or by an appraisal or engineering estimate, USACE will either reduce the book cost of the building or other structure by the amount of the unsupported costs or track the unsupported amounts by property identification code.

Because the OIG DoD will review only the COEMIS/CEFMS conversion spreadsheets for 43 sampled projects, USACE agrees to determine the availability of COEMIS/CEFMS conversion spreadsheets and written attestation statements for the assets in the projects not sampled. USACE agrees to reconcile differences between what was recorded in COEMIS at the time of conversion and what was distributed to the individual property identification codes on the conversion spreadsheets for entry into CEFMS. For changes made to existing assets since the development of the conversion sheet and new assets placed in service since the conversion, USACE agrees to ensure that sufficient source documentation exists in files maintained by the respective districts to substantiate the book cost recorded in CEFMS. Source documentation, such as an appraisal, or a written attestation statement should support the acquisition cost of revolving fund real property assets. USACE agrees to maintain all the documentation (original documents and/or hard and electronic copies of original documentation) in a readily available location, for the life of the assets.

**Construction-in-Progress.** USACE agrees to establish and implement procedures by November 15, 2004, that require that COEMIS costs that are associated with assets still in construction-in-progress be supported before associated assets are placed in service. In the new procedures, the Engineer Form 3013 for each transferred asset will indicate the dollar value of the capitalized costs originating in COEMIS for which sufficient source documentation does not exist. The Engineer Form 3013 will also identify the costs that originated in CEFMS that are supported by original documentation. USACE will obtain and provide a written statement from responsible USACE district personnel attesting that the costs assigned to the individual property identification codes were based on actual costs, where available, and/or an estimated cost based on project cost/general ledger records in COEMIS. USACE will attach the written statement with the supporting documentation, such as the CEFMS cost detail ledger as of the date of the conversion, to the Engineer Form 3013. The written statement, supporting documentation, or the Engineer Form 3013 will describe the types of goods or services that are associated with the capitalized costs for which sufficient source documentation does not otherwise exist. If any costs cannot be supported using this methodology, the book cost of the building or other structure will be reduced by the amount of the unsupported costs.

**Administrative Costs Associated With Land.** Reportable land costs are composed of the cost to acquire land tracts and all costs necessary to bring a tract of land to a form suitable for its intended use. This includes the administrative costs. Administrative costs associated with land on the FY 2003 Civil Works Balance Sheet represent approximately 70 percent of the \$8.1 billion recorded value for land. As with other real property, supporting documentation is not available for most of these administrative costs. To identify the administrative cost component, USACE agrees to separately identify total land tract costs and total administrative costs for each property identification code per district by May 2004.

From each of the districts, USACE will request the FYs 1994 to 1998 conversion data, the associated COEMIS/CEFMS conversion spreadsheets, and the signed attestation statements for all projects. The attestation statements indicate that costs assigned to the individual items were based on actual real estate records, where available, and/or an estimated cost based on project cost/general ledger records in COEMIS. For missing FYs 1994 to 1998 conversion spreadsheets or attestation statements, USACE will re-create the spreadsheets using the same information and methodology used to create the original spreadsheets. USACE will then annotate on the spreadsheets "non-original" and attest to the information and the methodology used to re-create them. If USACE cannot reconstruct the conversion spreadsheets, USACE will write off the recorded amounts or provide valid estimates. For administrative costs associated with land acquired after its conversion to CEFMS, USACE agrees that the districts must retain documentation supporting those costs in accordance with SFFAS No. 6, the DoD Financial Management Regulation, and NARA requirements.

The OIG DoD agrees to accept the conversion spreadsheets with signed attestation statements as alternative documentation that will approximate actual costs for the pre-CEFMS unsupported administrative costs of land. The baseline date will vary for each item depending upon when it was converted to CEFMS. Because the COEMIS or conversion data is alternative documentation, USACE agrees to select a judgmental sample of the available conversion spreadsheets from a minimum of one project each at five Power Marketing Administration districts and five non-Power Marketing Administration districts. USACE engineers will then validate the accuracy of the conversion data used to estimate project cost on the selected projects. USACE will provide the engineer-validated estimates to the IG DoD auditors. USACE also agrees to disclose all unsupported administrative costs (those costs not supported by actual real estate records or estimates) in the financial statement notes.

USACE agrees to reconcile differences between what was recorded in COEMIS at the time of conversion and what was distributed to the individual items on the conversion spreadsheets for entry into CEFMS. For changes made to existing items since the development of the conversion sheet and new items placed in service since the conversion, USACE agrees to ensure that sufficient source documentation exists in files maintained by the respective districts to substantiate the administrative costs recorded in CEFMS. USACE agrees to maintain all the documentation (original documents and/or

hard and electronic copies of original documentation) in a readily available location, for the life of the items.

## PART II. PERSONAL PROPERTY

**Background.** USACE uses several different types of equipment assets to perform its mission such as forklifts, trucks, cranes, barges, and boats. The equipment portion of PP&E generally includes assets with an acquisition value of \$25,000 or more. It does not include land, buildings and structures, and construction-in-progress. The net book value of equipment in the USACE principal statements in FY 2002 was \$650.8 million. The DoD Financial Management Regulation requires that supporting documentation for the assets be maintained by the owner in a readily available location during the applicable retention period. This permits the validation of information pertaining to the asset, including acquisition cost, acquisition date, and cost of improvements.

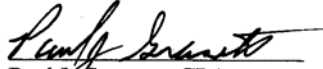
**Problem.** USACE did not maintain adequate documentation to support all of the values recorded in CEFMS for a significant number of items of equipment reviewed. This occurred because USACE had not developed the controls necessary to ensure personnel adhered to existing policies and procedures for retaining documentation and valuing assets in the absence of historical data. The valuation problem resulted in the audit conclusion that USACE could not adequately support about \$47.5 million of the \$650.8 million disclosed on the FY 2002 financial statements as the value of equipment.

**Agreement.** For personal property assets acquired as of September 30, 2002, USACE agrees, when original supporting documentation for personal property assets is no longer available, that the asset costs need to be determined and documented using acceptable methods of estimating costs. Acceptable procedures for valuing assets for which historical cost documentation is no longer available include:

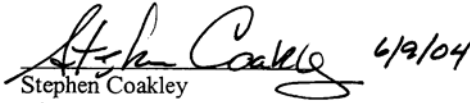
- appropriation or other Congressional information,
- Plant Replacement and Improvement Program documentation, if it can be used or adjusted to estimate the value of the assets at the time it was placed in service.
- estimated cost based on the cost of similar assets at the time of original acquisition, and
- current cost of similar assets, discounted for inflation since the time of acquisition.

USACE agrees to document the estimate on the USACE Internal Equipment Valuation (in Lieu of Supporting Documentation) form and have it certified by responsible personnel. For personal property acquired after September 30, 2002, USACE agrees that the districts must retain documentation supporting those costs in accordance with SFFAS No. 6, the DoD Financial Management Regulation, and NARA requirements.

This Memorandum of Agreement, once agreed to by all parties, will represent the official baseline for supporting the book cost of individual USACE, Civil Works, general PP&E. The official baseline dates are not rolling baselines; therefore, alternative valuation methodologies for real and personal property will not be accepted for any transactions that occur after the asset's baseline period. The undersigned agree that this memorandum expresses our understanding of the actions that the OIG DoD and USACE agree to take.



Paul Y. Granetto, CPA  
Assistant Inspector General, Defense Financial Auditing Service  
Office of the Inspector General of the Department of Defense



Stephen Coakley  
Director, Resource Management  
U.S. Army Corps of Engineers

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## Appendix C. Financial Improvement Initiative Checklist

The following is a checklist included in the Financial Improvement Initiative Business Rules Memo.

CHECKLIST	
<p>When performing corrective action validation and while preparing the assertion package, please complete the following checklist. Include the completed checklist as an attachment to your assertion letter.</p> <p>This check list is designed to help components prepare for audits by providing the information that is typically needed for financial statement audits. Keep in mind that the list of specific items you will need for an assessment or audit will come from the auditors in the form of a "Prepared By Client (PBC) List."</p> <p>The following steps may begin during the Discovery Phase or Correction Phase to assist those performing the assessment in validating that these steps have been completed.</p>	
<input type="checkbox"/>	1 Identify and document the procedures, processes, and control points for deriving the balance(s) being asserted. Include the systems that are used and the flow of data from field level to departmental level. This can be done in a cycle memorandum or flow chart format. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that makes up the balance(s) being asserted as ready for audit.
<input type="checkbox"/>	2 Have all General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balance(s) being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.
<input type="checkbox"/>	3 Consolidate evidential matter that supports the transactions in step 2 or map where the evidential matter is located for easy and expedient retrieval.
<input type="checkbox"/>	4 Prepare a summary of the validation work performed by management Service auditors, internal auditors, or independent public accounting firms to establish audit readiness, if applicable.
<input type="checkbox"/>	5 Complete all the corrective actions in your Mid-Range Financial Improvement Plan for the material deficiencies related to the balance(s) being asserted.
<input type="checkbox"/>	6 Using the information from number 5 above, prepare an explanation of the actions taken to fix previously identified or existing problems and incorporate the explanation in the assertion letter or include as attachment to the letter. Be very specific.
<input type="checkbox"/>	7 Compile organization charts indicating key personnel and their responsibilities and phone lists.
<input type="checkbox"/>	8 For all the systems identified in step 1 above, has there been a Financial Information Security Audit Manual Controls (FISCAM) or Statement of Auditing Standard (SAS) 70/88 audit conducted on the systems?
<input type="checkbox"/>	Yes If yes, provide the date and point of contact.
<input type="checkbox"/>	No

- ☐ 9 For the Systems identified in step 1 that you answered Yes in step 8, obtain a copy of the FISCAM or SAS 70/88 audit report and skip the rest of the steps. For the systems identified in step 1 that you answered No in step 8, proceed to step 10.

**If a FISCAM or SAS 70/88 audit has not been conducted on the system, then the auditors will have to perform alternate procedures on the system. Therefore, the following information will have to be gathered prior to the audit for each system.**

- ☐ 10 Prepare a description of the major hardware and software of the system and interfaces with other systems
- ☐ 11 Describe what type of data the system produces for the financial statements, e.g. accounting transactions
- ☐ 12 Prepare a description of telecommunications devices and networks used with the system.
- ☐ 13 Obtain a copy of the most recent certifications and accreditations of the system.
- ☐ 14 Identify the system location(s) and end user locations.
- ☐ 15 Identify the location(s) of system documentation.
- ☐ 16 Identify the type, dollar value, and number of transactions processed in the system in a month and in a year.
- ☐ 17 Obtain a list of all system users - this should be a print out that shows the user and level of access.
- ☐ 18 Inquire if there are any ongoing or planned system reviews - if there are, determine when the reviews will be complete.

# **Office of the Under Secretary of Defense (Comptroller) (OUSD(C))**

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## **Effective Internal Control for Financial Reporting Course**

### **Final Examination**

**Student Name:** \_\_\_\_\_

Prepared by:  
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Southbridge, MA 01550-2570



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## Final Examination

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**Directions**

This is an open-book final examination covering subject matter taught in the Effective Internal Control for Financial Reporting course. It will assess your knowledge of the general subject matter and requirements for reporting on your organization's internal control. This final examination consists of questions that are multiple choice and fill in the blank. Write in or circle the correct answer to the questions.

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**Time Allocation**

The time allocated to this examination is 40 minutes: 30 minutes for the exercise and 10 minutes for the critique.

Number	Question
1	<p>Integrity, ethics, and competence of personnel are examples of what component of internal control?</p> <ul style="list-style-type: none"><li>a. Risk assessment</li><li>b. Control environment</li><li>c. Control activities</li><li>d. Monitoring</li></ul>
2	<p>An audit trail provides information _____.</p> <ul style="list-style-type: none"><li>a. to physically track any single transaction from its inception to its appearance in the financial reports and statements</li><li>b. from the financial reports and statements back to the source documents</li><li>c. Both a and b</li><li>d. Neither a nor b</li></ul>
3	<p>The management assertion that ensures transactions adhere to the tenets of laws and regulations is _____.</p> <ul style="list-style-type: none"><li>a. Compliance</li><li>b. Completeness</li><li>c. Existence</li><li>d. Presentation</li></ul>

Number	Question
4	<p>Risk analysis is _____.</p> <ul style="list-style-type: none"><li>a. the process of applying risk identification to program areas and critical technical process risks</li><li>b. the process of examining each identified risk area or process to refine the description of the risk, isolate the cause, and determine the effects</li><li>c. the process of identifying, evaluating, selecting, and implementing options in order to set risk at acceptable levels given program constraints and objectives</li><li>d. All of the above</li></ul>
5	<p>Cycle memos are used by auditors to document_____.</p> <ul style="list-style-type: none"><li>a. internal control processes</li><li>b. process bottlenecks</li><li>c. audit trails from start to finish</li><li>d. transactions in the proper time period</li></ul>
6	<p>Control activities are_____.</p> <ul style="list-style-type: none"><li>a. a comparison and assessment of different sets of data for detailed tests</li><li>b. internal activities that help ensure that management directives are carried out</li><li>c. edit checks of substantive testing</li><li>d. the separating, processing, recording, and reviewing of duties of audit personnel</li></ul>
7	<p>You must identify risks within which categories of control objectives in order to estimate the likelihood of the occurrence of risk?</p> <ul style="list-style-type: none"><li>a. Recording, processing, and summarization</li><li>b. Economy, efficiency, and effectiveness</li><li>c. Financial reporting, compliance, operations</li><li>d. All of the above</li></ul>

Number	Question
8	<p>What government entity published the circular entitled Management's Responsibility for Internal Control?</p> <ul style="list-style-type: none"><li>a. Office of Management and Budget</li><li>b. Government Accountability Office</li><li>c. General Services Administrative</li><li>d. Department of Defense</li></ul>
9	<p>List the five standards of internal control.</p> <hr/> <hr/> <hr/> <hr/> <hr/>
10	<p>Financial reporting internal control _____.</p> <ul style="list-style-type: none"><li>a. ensures that transactions are properly recorded, processed, and summarized</li><li>b. safe guards assets against loss from unauthorized acquisition, use, or disposition</li><li>c. None of the above</li><li>d. Both a and b</li></ul>
11	<p>What can you use to provide the auditors with a better understanding of where internal control is required in a business process?</p> <ul style="list-style-type: none"><li>a. FAM Checklist</li><li>b. NARA</li><li>c. Flow charting</li><li>d. SOP</li></ul>

Number	Question
12	Control tests are performed on internal control to _____. a. see if an internal control is working as intended b. see if the entity is in compliance with laws and regulations c. obtain evidence that provides reasonable assurance d. find out which level of internal control is applicable
13	In designing an internal control, you must first perform a risk _____. a. intervention b. mitigation c. assessment d. design
14	“Transactions are clearly documented” is an example of what type of control? a. Accounting Control b. Financial Control c. Operations Control d. Administrative Control
15	According to the guidance set forth in the DoDD 5010.38, Departments will _____. a. establish a MIC Program b. take action to identify and correct inefficient internal controls c. establish new internal controls as needed d. All of the above